MINISTRY OF INVESTMENT
Financial Sector Reform in Egypt: Achievements & Challenges

Financial & Private Sector Development Forum 2007

Finance and Markets for All: What, Why, When, and How?

Financial Sector Reform in Egypt: Achievements and Challenges

April 26, 2007
Financial Sector Reform in Egypt: Achievements & Challenges

“Financial Sector Reform Program”

This reform program launched in September 2004 is considered the most far reaching, substantive and comprehensive in Egypt and in MENA region …

Reform Objectives

Improve the soundness and efficiency of the financial sector through comprehensive structural and financial reform, which would ultimately boost economic growth and development as well as enhancing competitiveness, and financial innovation.

1. Reforming the Banking Sector
2. Deepening the Capital Market
3. Restructuring the Insurance Sector
4. Developing a Well-functioning Mortgage Market
5. Improving the Institutional Framework

Main Components of the Program

Time Frame

2005-2008

With clear timeline and detailed benchmarks
Preconditions for Success

- Supportive political economy
- Commitment of the government
- Transparency and willingness to address issues openly
- Compatible legal and regulatory environment
- Competent implementing entities
- Availability of financial resources
- Comprehensive and irreversible financial sector reform program
I. Reforming the Banking Sector

- Consolidation of banking systems through merger and acquisition of small and weak banks
- Operational and institutional restructuring of state-owned banks
- Financial restructuring and resolution of non-performing loans (NPLs)
- Privatization of one of the state-owned banks
- Divesting public sector shares in the joint venture banks
- Strengthening the supervisory authority of the Central Bank
II. Deepening the Capital Market

- Increasing market capitalization and liquidity
- Protecting investors and maintaining integrity through law enforcement and compliance with international codes and standards.
- Introducing new medium and long-term financial instruments and benefiting from the advance of financial innovation.
- Establishing the Egyptian Institute of Directors to participate in the proper dissemination of corporate governance principles in the Egyptian market.
- Deepening market structure through introducing new financial tools:
  - Strengthening the investors purchasing power through the launch of the margin trading activity, which would in turn trigger the market momentum.
  - Introducing the short selling activity as hedge tool to mitigate market risks.
III. Restructuring the Insurance Sector

- Restructuring and privatizing state-owned insurance companies.
- Encouraging private sector participation.
- Separating non insurance related assets such as real estate related portfolio.
- Strengthening the insurance regulations, underlying accounting principles and commercial codes.
- Promoting market discipline through disclosure, competition and good internal governance.
- Addressing the issue of the tax treatment of insurance premiums.
- Ensuring compliance with the internationally accepted standards.
IV. Developing a Well-functioning Mortgage Market

- Creating an efficient enabling environment for a competitive and sustainable mortgage market.
- Establishing a market based liquidity facility.
- Improving housing affordability while deepening capital market activities.
- Reducing lending and funding risks for mortgage lenders and the investors in mortgage securities, as well as, lowering cost of funds and mortgage lending rates.
- Enhancing and strengthening the regulatory framework for mortgage lending.
- Modernization of the system of property rights registration, streamlining the procedures and lowering the registration fees.
- Facilitating the procedures for property repossession in case of default.
- Unifying and ensuring an adequate approach to property valuations.
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V. Improving the Institutional Framework

- Strengthen the legal and regulatory framework to enhance the quality of financial supervision.
- Develop corporate governance and strengthen internal audit controls, checks and balances.
- Develop and introduce market-based institutions such as private credit bureaus.
- Separation between monetary policy function and bank supervision function within the central bank.
- Unification of non-bank financial services policies under one competent ministry and ensuring adequate coordination between all non-bank financial regulators (CMA, EISA, and MFA)
- Develop and upgrade the necessary specialized skills and knowledge among staff working in the supervisory bodies to meet current and anticipated challenges posed.
Implementation of the Financial Sector Reform Program

Significant progress made. . . and in many areas they have gone beyond the timeline
Consolidation of the banking system

The consolidation of the banking system is expected to enhance competition in the market.

- Minimum capital requirement for local and foreign banks under Law 88 of 2003 was raised, leading small banks to consolidate, raise their capital or shut down.
- A number of European and Arab banks have entered the Egyptian market over the past two years, either through buying public shares in joint venture banks, or through increased investments in their existing banking assets.
Consolidation of the Banking Sector

*Through a series of acquisition, consolidation, and mergers the number of banks has declined from 57 in 2004 to 39 in 2007.*

<table>
<thead>
<tr>
<th>Entity</th>
<th>Acquirer</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Misr Exterior</td>
<td>Banque Misr</td>
<td>September 2004</td>
</tr>
<tr>
<td>Crédit Agricole</td>
<td>Calyon-Egypt</td>
<td>April 2005</td>
</tr>
<tr>
<td>American Express</td>
<td>Egyptian American Bank</td>
<td>June 2005</td>
</tr>
<tr>
<td>Misr America Bank</td>
<td>Arab African International Bank</td>
<td>July 2005</td>
</tr>
<tr>
<td>Mohandes Bank</td>
<td>National Bank of Egypt</td>
<td>October 2005</td>
</tr>
<tr>
<td>Islamic Bank for Investment and Development</td>
<td>United Bank</td>
<td>June 2006</td>
</tr>
<tr>
<td>Nile Bank</td>
<td>United Bank</td>
<td>June 2006</td>
</tr>
<tr>
<td>the Egyptian United Bank</td>
<td>United Bank</td>
<td>June 2006</td>
</tr>
<tr>
<td>Egyptian American Bank (EAB)</td>
<td>Credit Agricole</td>
<td>August 2006</td>
</tr>
<tr>
<td>Misr International Bank (MIbank)</td>
<td>National Societe General Bank (NSGB)</td>
<td>November 2006</td>
</tr>
</tbody>
</table>
Divestiture of Joint Venture Banks

*State-owned banks shares in 13 joint venture banks has been divested.*

<table>
<thead>
<tr>
<th>Bank</th>
<th>Divested Public Shares</th>
<th>Bank</th>
<th>Divested Public Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Egyptian American Bank</td>
<td>33.8%</td>
<td>National Société Générale Bank</td>
<td>18.7%</td>
</tr>
<tr>
<td>Cairo Barclays Bank</td>
<td>40%</td>
<td>Misr America International Bank</td>
<td>48.9%</td>
</tr>
<tr>
<td>Misr Romania Bank</td>
<td>33.3%</td>
<td>Egyptian Commercial Bank</td>
<td>9.8%</td>
</tr>
<tr>
<td>Suez Canal Bank</td>
<td>5%</td>
<td>Misr International Bank</td>
<td>25.9%</td>
</tr>
<tr>
<td>Commercial International Bank (CIB)</td>
<td>18.9%</td>
<td>Misr Iran Development Bank</td>
<td>30%</td>
</tr>
<tr>
<td>Delta International Bank</td>
<td>10.2%</td>
<td>Cairo Far East Bank</td>
<td>19.6%</td>
</tr>
<tr>
<td>Alexandria Commercial &amp; Maritime Bank</td>
<td>5%</td>
<td>Egyptian Saudi Finance Bank</td>
<td>5.3%</td>
</tr>
<tr>
<td>Egyptian Workers Bank</td>
<td>9.8%</td>
<td>Cairo BNP Paribas Bank</td>
<td>4.8%</td>
</tr>
<tr>
<td>Export Development Bank of Egypt</td>
<td>34.5%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
State Ownership in the Banking Sector has been Declining

Privatization of Bank of Alexandria

- Selecting the fourth largest state-owned bank—Bank of Alexandria, accounting for 6% of the banking system with a huge branch network.
- Hiring a reputable sale advisor through an international bidding process
- 80% of the bank was sold to an Anchor investor—San Paolo IMI
- Total transaction value is US$ 1.6 billion—the highest multiple realized in recent privatization transaction not only in Egypt but in the MENA region.
- This privatization transaction is expected to enhance competition in the overall banking system.
- This action is a key bench mark for the government's commitment to reform.
State Ownership in the Banking Sector has been Declining

The banking system is now dominated by the private sector and the market share of state-owned banks in system’s deposits has declined from 58% in 2004 to 49% in 2007.
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Financial restructuring of state-owned banks

*Asset Management Program plays a major role in addressing the problem of NPLs*

Non-performing Loans of SOEs has been declining significantly
Asset Management

The pace of the privatization program has significantly picked up . . . . As evident in the rise in sales proceeds . . . .

![Graph showing sales proceeds from 2000/01 to 2006/07 (Jul-Mar)]
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Asset Management Program

*Most of the sales proceeds since July 2004 have been allocated to settle NPLs*

Total Sales Proceeds since July 2004

EGP 33.3 Billion

- Transferred to the Ministry of Finance
  - EGP 16.82 Billion
    - Settlement of NPLs
      - EGP 9.1 Billion
- Proceeds of Sale of Land and Unutilized Assets
  - EGP 1.149 Billion
- Public Sector Companies Share
  - EGP 13.72 Billion
- Under Collection
  - EGP 1.61 Billion
- Funds Directed to the Restructuring Fund
  - EGP 1.375 Billion
- Funds Available to the Restructuring Fund (original fund balance of EGP 0.4 Billion is added)
  - EGP 2.9 Billion
- Restructuring Costs (since July 2004 to date)
  - EGP 1.7 Billion
Financial sector reform is going hand in hand with the restructuring of state-owned enterprises . . . . As evident in the rise in SOEs net profits.
Achievements in the Capital Market

- The stock exchange is trading the equities of over a thousand companies.
- Enhanced market surveillance through launching an automated trading system, enabling an on-line surveillance and ensuring market efficiency.
- Regulated primary dealer activities in government bonds in order to deepen the domestic debt market.
- Issued a new listing and delisting rules, enforcing more disclosure and transparency requirements in order to create stronger financial institutions.
- Ensured good corporate governance through setting the necessary rules and regulations, and protecting shareholder ownership rights, assignment of responsibilities, oversight of management, board independence, loyalty duties, voting, takeovers and enforcement.
- Adopted a comprehensive capacity building program
- Established new departments performing key regulatory functions
- Approved the new Cairo and Alexandria Stock Exchange membership rules aiming at limiting risks associated in dealing the stock market
- Improved the regulatory framework to ensure capital market efficiency
Capital Market

CMAI and CASE 30 (Jul 04 – Mar 07)
Capital Market

The market capitalization has been rising significantly

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Capital Market

**Acquisitions via the Exchange**

- **Value of Acq. (EGP Billion)**
- **Number of Acq.**

<table>
<thead>
<tr>
<th>Year</th>
<th>Value of Acq.</th>
<th>Number of Acq.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>3.86</td>
<td>14</td>
</tr>
<tr>
<td>2002</td>
<td>2.53</td>
<td>9</td>
</tr>
<tr>
<td>2003</td>
<td>1.43</td>
<td>13</td>
</tr>
<tr>
<td>2004</td>
<td>1.83</td>
<td>9</td>
</tr>
<tr>
<td>2005</td>
<td>19.77</td>
<td>37</td>
</tr>
<tr>
<td>2006</td>
<td>36.58</td>
<td>41</td>
</tr>
</tbody>
</table>

**Net Portfolio Investment**

- **USD Million**
- **Bonds**
- **Equity**
- **Total**

<table>
<thead>
<tr>
<th>Year</th>
<th>Bonds</th>
<th>Equity</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000/01</td>
<td>260.5</td>
<td>-5</td>
<td>-265.5</td>
</tr>
<tr>
<td>2002/03</td>
<td>-405.2</td>
<td>-225.6</td>
<td>-630.8</td>
</tr>
<tr>
<td>2004/05</td>
<td>831.1</td>
<td>56.9</td>
<td>888</td>
</tr>
<tr>
<td>2006/07</td>
<td>2,764</td>
<td></td>
<td>2,764</td>
</tr>
</tbody>
</table>

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MSCI Egypt vs. MSCI Emerging Markets

Value & Volume of Listed & OTC Traded Securities
Progress made in restructuring the insurance sector

- Established the Insurance Holding Company with a clear mandate to restructure and privatized state-owned insurers
- Operational and institutional restructuring of state owned insurance companies is underway
- Stamp duty law 143 was issued in 2006 by which stamp duty imposed on insurance company was dropped by 50%
- Finalized an action plan supported by international consortium for restructuring and privatization of state-owned insurance companies
- Established Misr Real Estate Asset Management Company under which non own real estate will be transferred
- Capacity building of Egyptian Insurance Supervisory Authority (EISA)
- EISA moving from compliance based supervision to risk based supervision
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Insurance Sector

*Market Structure as of June 2006*

- **Life**
  - Total Private Sector: 48%
  - Misr Insurance: 24%
  - El Chark Insurance: 22%
  - National Insurance: 6%

- **Non Life**
  - Total Private Sector: 26%
  - Misr Insurance: 50%
  - El Chark Insurance: 17%
  - National Insurance: 7%
Insurance Sector

Insurance Premiums as a Percent of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>Insurance Premiums as % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999/2000</td>
<td>0.59</td>
</tr>
<tr>
<td>2000/2001</td>
<td>0.59</td>
</tr>
<tr>
<td>2001/2002</td>
<td>0.63</td>
</tr>
<tr>
<td>2002/2003</td>
<td>0.73</td>
</tr>
<tr>
<td>2003/2004</td>
<td>0.8</td>
</tr>
<tr>
<td>2004/2005</td>
<td>0.8</td>
</tr>
<tr>
<td>2005/2006</td>
<td>0.8</td>
</tr>
</tbody>
</table>
Progress made in the mortgage market

- Issued Real Estate Finance Law 148 in June 2001, setting out the foundations for a market-based system, introduced various mechanisms for long-term mortgage finance.
- Established Egyptian Mortgage Refinance Company in 2006 to enable qualified mortgage lenders to access term refinancing for mortgage loans and better manage the risks of mortgage lending.
- Amended the Capital Market Law, and Mortgage Finance Law, allowing securitization.
- Capacity building and new management for the Mortgage Finance Authority (MFA).
- Amended the Executive Regulation of the Mortgage Finance Law to address various loopholes.
Development of the mortgage market is evident in the significant rise in the value of availed mortgages by mortgage companies and banks.
Achievements in other Non-bank Financial Institutions

- Developing the financial leasing Industry
  - Exempted leasing companies from stamp duty and removed obligations to limit debt interest to a maximum of four times their capital
  - Eliminated restrictions on leasing companies lease of assets including land, car, and tourism buses
  - Simplified the contracts-registration process
  - Revised the Leasing Association to provide a forum to voice to leasing companies’ concerns and to ensure dissemination of best practice

- Fostering the Factoring Industries
  - Amended the Executive Regulations of the Investment Law, setting the main rules and regulations governing factoring activities, licensing requirements, registration requirements and procedures
  - Established surveillance that includes financial adequacy, credit risk protection, disclosure, accounts receivable bookkeeping, and collection services.
  - Facilitated the entry of factoring corporations
The Financial Sector Reform Program has paid off …
The “Financial Sector Reform Program”

Domestic credit growth shows that credit allocated to the government and state-owned enterprises has been declining . . .
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Credit Stock Breakdown

...while credit allocated to the private sector and household has been rising...
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... and private investments has been rising

Private Investments as a Percent of Total Investments

% of Total Investments

34% 48% 48% 51% 47% 48% 47% 51% 61% 67%


Private Share in Gross Fixed Capital Formation
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New Establishments

Expansions
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FDI as % of GDP

FDI (value)

USD Million

FDI Sectoral Breakdown

<table>
<thead>
<tr>
<th>Year</th>
<th>Oil Inv</th>
<th>Sales of Assets to Foreigners</th>
<th>New Estab &amp; Expansions</th>
<th>Real Estate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004/2005</td>
<td>65.1%</td>
<td>23.7%</td>
<td>10.8%</td>
<td>0.4%</td>
</tr>
<tr>
<td>2005/2006</td>
<td>65.1%</td>
<td>23.7%</td>
<td>10.8%</td>
<td>0.4%</td>
</tr>
</tbody>
</table>
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Public vs. Private Investments as a Percent of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>Public Investment</th>
<th>Private Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998/99</td>
<td>10.9%</td>
<td>9.9%</td>
</tr>
<tr>
<td>1999/00</td>
<td>9.9%</td>
<td>9.1%</td>
</tr>
<tr>
<td>2000/01</td>
<td>8.7%</td>
<td>9.0%</td>
</tr>
<tr>
<td>2001/02</td>
<td>8.4%</td>
<td>9.4%</td>
</tr>
<tr>
<td>2002/03</td>
<td>8.5%</td>
<td>7.9%</td>
</tr>
<tr>
<td>2003/04</td>
<td>8.7%</td>
<td>7.6%</td>
</tr>
<tr>
<td>2004/05</td>
<td>8.8%</td>
<td>9.1%</td>
</tr>
<tr>
<td>2005/06</td>
<td>7.3%</td>
<td>11.4%</td>
</tr>
<tr>
<td>2006/07</td>
<td>6.8%</td>
<td>13.5%</td>
</tr>
</tbody>
</table>
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... and real economic growth has been rising
remain committed to the completion of a successful Financial Sector Reform Program