

# Algerian banking: in search of a new business model

Information on Algerian banks is hard to find, but anyone who has been working with Algerian banks and companies knows that until recently both local and foreign Algerian banks were highly profitable.

But now the days of easy profits are over. The Algerian government has taken steps to reduce the fees that banks can earn on trade finance, while low oil prices are reducing liquidity and compromising asset quality across the banking sector. Yet the picture is not all gloomy: the Algerian Central Bank is pushing banks to upgrade their internal controls, and is doing what it can to inject liquidity into the system.

*Arab Banker* spoke to Rachid Sekak – who led the renegotiation of Algeria's foreign debt in the 1990s, and more recently established and led HSBC's branch in Algiers – about the challenges that Algerian banks are facing and their options for the future.

## **ARAB BANKER: Could you describe the current structure of the Algerian banking system?**

RACHID SEKAK: There are six state-owned banks and 14 private banks that are wholly or partly owned by non-Algerian interests. Among the state-owned banks, Banque Nationale d'Algérie (BNA), Banque Extérieure d'Algérie (BEA), and Banque de l'Agriculture et du Développement Rural (BADR) are the biggest, while among the private banks, Société Générale, BNP Paribas, Natixis and Algeria Gulf Bank (a subsidiary of Kuwait's Burgan Bank) have the largest networks.

BNA and BEA have assets of about \$30 billion, which is much bigger than the other banks. The total assets of the banking system are about \$115 billion.

Figures from the Banque d'Algérie (the Central Bank) show that the public sector banks accounted for 88% of deposits in the banking system at the end of 2014 and also 88% of credit. Of 1,428 bank branches in Algeria, 1,113 – 80% – belonged to the state-owned banks. As for banking staff, of 36,287 at the end of 2014, 82% worked for the state-owned banks.

However, the picture changes if you look at the market share of import trade finance. Here, private banks account for more than 50% of all business.

## **How do Algerian banks make money?**

The state-owned banks finance state-owned companies and are also significant lenders to the private sector. In contrast, the private banks are focused solely on the private sector, and about 70% of their business entails providing working capital.

For about ten years, state-owned enterprises were prohibited from doing business with private sector banks – either on the deposit side or the borrowing side. These restrictions arose following the failure of some small private banks in the early 2000s: Khalifa Bank is the best known.

Even though the restrictions have now been lifted, in practice state-owned enterprises are reluctant to work with the private sector banks. This is because managers can go to gaol if they make bad decisions.

## **How have recent policy changes affected the profitability of Algerian banks?**

In 2009, the Algerian government tried to reduce imports by requiring importers to use documentary credits – this enabled the government to keep greater control of what was being brought into the country because the Central Bank was the source for all of the foreign exchange needed to process the documentary credits. At the same time, the authorities put a ban on certain forms of consumer credit, such as car loans. This was another attempt to reduce imports.

At this time, the commissions on trade finance were huge – maybe two or three times what you could earn elsewhere in North Africa. The banks chose not to try to undercut each other so rates stayed high.

But since 2013, the Central Bank has taken two measures to limit the profits that the banks can make. First, it put a cap on trade finance fees and, secondly, it restricted the amount of foreign business that banks could do in relation to their equity. Initially, documentary credits were limited to four times capital, and then in 2014 the ratio was reduced to two times capital, and then in 2015 to one times capital.

## **The fall in oil prices, which began in mid-2014, has had a severe impact on the Algerian government's budget and current account position. How has it affected the banks?**

For the moment the banks are in a reasonably strong position. The capital ratio of the system as a whole was 17% at the end of 2015 (compared to 16% at the end of 2014), of

which 14% comprised Tier 1 capital. The figures for private banks are significantly higher than the average. The system's return on equity was 24.6% during 2015 and its return on assets was 2.2%.

On the other hand, with the slump in oil prices, the days of cheap deposits and low funding costs are over. Liquidity is tightening. Deposits in the system decreased in 2015, and the loans to deposits ratio increased from 69.5% at the end of 2013 to 74.7 at the end of 2014 and 86.7% at the end of 2015.

The banks are also going into the current time of difficulties with fairly high levels of non-performing loans (NPLs): 9.5% for state-owned banks and 8.7% for the private banks, according to IMF estimates, although it is worth noting that, until recently, NPLs at the state-owned banks were trending down.

Liquidity is tightening, although the Central Bank has taken steps to alleviate liquidity shortages: in April 2016 they reduced the reserve requirement to 8% from 12%, liberating \$4 billion in liquidity; and in March 2016 they re-opened the discount window, allowing banks to swap eligible bonds for cash.

### Looking beyond the immediate liquidity squeeze, what are the fundamental challenges that Algerian banks face?

For the state-owned banks, the main issues are governance and management information systems.

The Presidents-Directeurs-Généraux (PDGs) of the state-owned banks are appointed by the Treasury and they tend to move from one state-owned bank to another during their banking careers. We need the staff inside these banks to be more commercially-minded and more aggressive in seeking new opportunities and driving profits. Some of the public banks have started to move in the right direction but it will be a long journey.

The management information systems at the state-owned banks are outdated and need to be replaced. Even good commercially-orientated managers will not be able to make state-owned banks more efficient and profitable if they don't have good management information systems to tell them how their portfolios are performing.

Furthermore, strengthening ALM capabilities will be a crucial issue in raising awareness of financial risks.

As for the private banks, their challenge is to develop broad-based franchises rather than relying on niche markets. I think those private banks that have big branch networks

### Large Algerian banks, summary financials (end-2014)

End 2014 (DZD Mn)	Banque Nationale d'Algérie	Banque Extérieure d'Algérie	Banque de l'Agriculture et du Développement Rural
Loans to clients	1,831,665	877,653	659,397
Loans to financial institutions	55,145	753,789	295,545
Assets/liabilities	2,620,619	2,581,393	1,376,079
Customers' accounts	1,742,546	2,095,988	1,376,079
Capital and reserves	147,845	162,064	1,222,024
Net profit	298,784	29,808	6,125
Memo item Assets/liabilities in \$mn*	29,967	29,519	15,736

\* Exchange rate used: \$1 = DZD 87.45 (the rate at the end of 2014)

Source: Bank Reports

will be best placed to thrive in future, in part because they will be able to collect sticky deposits more easily, but also because they will have a broader range of customers.

### Is the Banque d'Algérie implementing the Basel standards?

The Banque d'Algérie has been taking important steps to improve the regulatory and supervisory framework. It has begun applying Basel II and some aspects of Basel III. It has some basic liquidity standards which it expects banks to meet, but it is not yet introducing the liquidity coverage ratio or the net stable funding ratio.

It is also worth mentioning that the Central Bank has recently introduced stronger accounting standards and higher standards for risk management.

Prudential and regulatory frameworks have been upgraded over the last few years but still need to be enhanced.

### How will the structure of Algerian financial markets change in the years ahead?

It's possible that one or two of the state-owned banks will be partially privatised in the next few years. Privatisation

### Algerian commercial banks: aggregate assets and liabilities

	Sep-15 US \$ bn*	Sep-15 DZD bn	Dec-14 DZD bn	Dec-13 DZD bn	Dec-12 DZD bn	Dec-11 DZD bn
Credit to the private sector	33.2	3,505.10	3,119.70	2,719.90	2,244.70	1,981.50
Credit to public sector enterprises	35.1	3,707.60	32,246	2,434	2,040.2	1,741.7
Credit to the state	14.2	1,496	1,472	1,334.3	1,403.9	1,406.1
Banks abroad	0.1	12.7	6.1	7.5	50	53.8
<b>Assets/liabilities</b>	<b>115.4</b>	<b>12,176.8</b>	<b>11,976.4</b>	<b>10,320</b>	<b>9,654.4</b>	<b>9,002.4</b>
Private sector deposits	43.1	4,544	4,376.3	4,001.2	3,644.6	3,192
Public sector deposits	29.0	3,060.2	3,197.9	2,610.2	2,530	2,631
Deposits from the state	5.1	541.8	557.8	502.5	473	346.4
Foreign liabilities	1.7	175.3	138.3	93.9	75.9	39.5
Capital and reserves	7.9	835.5	744.4	724.2	667	609.9

\* Figures in Algerian dinars converted to dollars at the rate of \$1 = dinar 105.5, the rate applicable at the end of September 2015.

Source: Banque d'Algérie, Bulletin Statistique Trimestriel, Décembre 2015.

would serve several objectives: raising money, bringing new expertise and products into the banks, and, potentially, increasing the range of shares traded on the stock exchange.

It is difficult to say whether new banking licences will be issued. The stumbling block is the 51/49 rule introduced in 2009, under which foreigners may own no more than 49% of Algerian companies. The rule was not retroactive, so those foreign banks that are already majority owned by foreign interests are not affected, but 51/49 is a disincentive to new investors. And I do think that Algeria would benefit from new banks and more competition.

A large proportion of the population is unbanked. We need to develop new products such as leasing and factoring. The government has recently lifted restrictions on car financing and consumer credit. Mobile and internet banking is not well developed in Algeria, although a vast country such as ours is exactly the sort of place where mobile and internet banking could bring real benefits very quickly. There are plenty of opportunities to build profitable banking businesses in Algeria.

### Who will be taking the decisions on these matters?

The supervision of the banks is under the authority of the Banque d'Algérie and its governor, Mohamed Loukal. The Ministry of Finance will have to take the lead on modernising the state-owned banks, since it is the Ministry that owns them.

I would add that Governor Loukal, who was appointed in June 2016, has considerable experience both of domestic banking and of international banking. He was previously the

head of Banque Extérieure d'Algérie and in that capacity has been a director of London-based British Arab Commercial Bank, and two Paris-based banks, UBAF and Banque Internationale Arabe.

### Will Algeria get a credit rating from one of the big international credit rating agencies?

I don't think government officials see the need for a credit rating right now. Personally, I think they should get a credit rating since that would be most useful for future external borrowing, would facilitate the flow of foreign direct investment and would also greatly improve the perception of the local business environment. It would also facilitate the creation of a bond market. We do need to develop an Algerian government bond market with a yield curve that private sector firms can use to benchmark their own credit raising efforts.

### What do you think the Algerian government's top three priorities should be for the banking and financial system in the coming year or two?

Going forward, key priorities include:

- A careful calibration of monetary policy to address simultaneously tightening liquidity issues and the necessity to control inflationary pressures. Not an easy task and a real challenge!
- The promotion of better access to credit for small and medium-sized enterprises and the private sector as a whole.
- The development of domestic capital markets to facilitate the financing of forthcoming fiscal deficits and to encourage economic growth.
- To complete the above, I would add the IMF's recommendation of "enhancing creditors' rights, modernising the bankruptcy framework and improving debt enforcement procedures" as an important priority. ■

### Algerian banks: financial ratios

(Ratios taken from the IMF's Article IV Consultation, May 2016)

	2015 (Preliminary)	2014	2013	2012	2011
<b>Capital adequacy</b>					
Public banks	16.2	14.9	19.9	21.6	21.9
Private banks	20.6	20.9	28.5	31.9	31.2
<b>NPLs/total loans</b>					
Public banks	9.5	9.7	11.4	12.4	16.1
Private banks	8.7	5.1	4.8	5.2	4.0
<b>Provisions/classified loans</b>					
Public banks	63.4	64.8	67.4	69.4	69.9
Private banks	44.9	71.9	80.3	71.7	75.9
<b>Return on equity</b>					
Public banks	27.7	25.1	17.9	22.7	26.1
Private banks	15.7	19.6	21.6	24.8	21.4
<b>Return on assets</b>					
Public banks	2.1	1.8	1.3	1.6	1.8
Private banks	3.1	3.3	3.8	4.6	4.5
<b>Liquid assets/total assets</b>					
Public banks	25.9	37.0	39.4	45.1	51.1
Private banks	35.9	44.0	46.5	50.9	43.2
<b>Liquid assets/short-term debt</b>					
Public banks	62.8	83.4	95.7	110.7	106.6
Private banks	69.8	75.4	84.1	93.5	84.6

Source: Algeria, 2016 Article IV Consultation, May 2016.



### Rachid Sekak MBE

Rachid Sekak MBE leads BRS Consultants & Associés, a consultancy based in Paris that provides strategic and financial consulting services to multinational companies, banks, financial institutions and governments throughout Africa, MENA and Mediterranean regions.

Rachid opened and led the operations of HSBC Algeria from 2007 to 2013 as its Chief Executive Officer, having joined the HSBC Group in 2006. He had previously worked for the Union de Banques Arabes et Françaises first as General Manager for branches and Asia, and then as General Manager of one of the commercial divisions. In 1990, he had been appointed to the post of Special Advisor to the Governor of Algeria's Central Bank and was later promoted to Secrétaire General du Conseil de la Monnaie et du Crédit, the Bank's Board of Directors. He subsequently was appointed Director of External Debt and as Chief Debt Negotiator, shaping the Algerian debt renegotiations with the London Club and Paris Club.

Rachid started his career as a teaching assistant at the University of California and at the University of Algiers. In 2014, Rachid was honoured by Her Majesty the Queen as a Member of the Order of the British Empire (MBE).