Tuesday 29 September 2009

Workshop B

New Age Banking in the Post-Crisis Era

The panel was moderated by **Dalia Abdel Kader** (DAK), Head of Marketing and Communications Department, AAIB, with panelists: **Arthur Koops** (AK), Head of Risk, AAIB; **Hala El Said** (HS), Executive Director, The Egyptian Banking Institute, Central Bank of Egypt; **James Gohary** (JG), Senior Manager of Operations, International Finance Corporation. Below are excerpts from the session.

DAK: Last year we held our workshop on the financial crisis and its implications. Our objective today is to look ahead and identify what exactly "new age banking" is. Egypt is well placed; the Egyptian banking system was sheltered from the crisis, thanks to the reforms and updates applied to this system. We must now take advantage of the learning curve, created by these reforms. Now, it is time for us to utilize the knowledge we have gained from this experience. The single message of this workshop is that banks need to raise their profit margins, in a stable manner that ensures long term profits. In order to achieve this we must focus our efforts on 3 crucial areas; risk management, corporate governance and sustainability.

AK: "Banks are an industry that has failed" was the front page headline of the Economist last May. The banking industry failed in developed countries, not in developing countries. The Egyptian market had a scare too, most of which was caused by the boost that risk management is getting at the moment. Since Board of Directors and CEOs are better listeners, corporate governance ends up getting more attention. There is pressure on the risk management sector, and banks are more preoccupied with the liability side of their balance sheets. Currently, there is a battle over who is going to conquer retail customer deposits, since these types of deposits are more stable, especially when compared to wholesale funding which is very risky.
There has been a slow down in the growth of Egyptian banks balance sheets, which is a good things, as it means we are applying basic banking rules. One of these rules states: "don't lend to anyone that does not merit it"; this will make access to loans very difficult. This rule brought about the creation of de-leveraging in the market. Meaning, you give a new loan to a company that has done very well for itself, and has a good pay back track record. Tenders of loans are down slightly, which is also good, as 5 years should be the maximum maturity for bank loans. Loans that are paid back over a period longer than 5 years only exist in fairytales. What does this mean for competition in Egypt? It means that competition amongst entities will improve. This will lead to more competition, which will force banks to be more transparent; sharing the risks of their bank. All of this will eventually strengthen the risk management of banks, and more daring strategies will be developed in the years to come.
In summary, the Egyptian market is okay, risk management is at the center of attention, swinging towards more sustainable development, and the Egyptian business model has not been broken, but is in fact, currently being improved.

DAK: The balance between being conservative and continuing to encourage progress is very important.

HS: Corporate governance is essential if we are to maintain trust. It is a must for banks, especially in time of recession. Why is corporate governance important for banks? Corporate governance is important, because it guarantees a healthy economy. Corporate governance is dependent on the operations of banks and the manner in which their businesses cater to the interests of their stakeholders and depositors. The public can monitor and exert corporate governance over corporations, so that banks localize and allocate financial resources to emerging markets. We do not rely heavily on the capital market in Egypt, and this is why corporate governance is important. When you extend credit facilities, you must make sure you have proper governance otherwise banks are prone to market failure, which would lead to systemic risk. There are many measures to gauge the effectiveness of governance, the most important of which include: the role of the board and their capability to make critical decisions, the effectiveness of their control over the distribution of these roles, the reliable and timely nature of information, and the alignment of compensation and incentives.
So, what went wrong during the financial crisis? Well, there were numerous failings, all of which resulted from weaknesses in the role of the board, in the members of the board, in the regulatory and supervisory framework, and in the compensation and incentives sector. When we look at the role of the board, banks are facing serious risks that need economic experts to analyze. Many banks face problems in hiring non-executive board members and the compensation and incentives sector remains weak because of the link between remuneration and performance. The role of credit rating agencies, and how their ratings are being used, is also important. Banks didn't have their own measurement and were relying on credit rating agencies.
So, how can we reform this industry? Is it a case of having better regulations? Further research is need if these questions are to be answered. Risk measurement methods are too quantitative and need real ecometrician. So, where do Egyptian banks stand? Well, there has been considerable progress thanks to the Central Bank's reforms. The level of the Central Bank of Egypt's supervision department was upgraded, and now meets international standards, and proper training programs and enhancement access to finance were facilitated.

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JG: Environmental and social sustainability are sub-components of corporate governance and risk management. The IFC started to screen projects on the basis of sustainability in the early 90's, defining their own guidelines and establishing their own standards. The IFC also set up a system to evaluate risks. The most important thing is that projects should cause no harm to either people or the environment. These concepts should be utilized in the corporate governance and risk management sectors.
When, in the 1990's some of the world's major banks faced problems, a meeting was held, during which these banks agreed to integrate the standards of the IFC, into their own business models. Some of the many standards utilized by these banks fall under the following topics: social and environmental assessment and management systems, labor and working conditions, pollution prevention and abatement, community health, safety and security and land acquisitions. By adopting these standards in emerging markets, these banks benefited from access to risk management tools and new business opportunities. These factors allowed these banks to develop better public images and create winning strategies for long term business growth.

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