SM/08/21
Correction 2

July 1, 2009

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Algeria—Financial System Stability Assessment—Update**

The attached correction to SM/08/21 (1/17/08) has been provided by the staff:

Mischaracterization of the Views of the Authorities

Page 4, para. 4, line 4: for "The recent decision to postpone indefinitely the first privatization of a large state-owned bank is a major setback" read "Unfortunately, in December 2007, the first privatization of a large state-owned bank—a key recommendation of the 2003 FSAP—was postponed until further notice in relation with deteriorating international market conditions."

Questions may be referred to Mr. Durand, MCM (ext. 38555).

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (1)

Other Distribution:
Department Heads

GLOSSARY

AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
ARTS	Algerian Real Time Settlement
ATCI	Algérie Télécompensation Interbancaire
BA	Bank of Algeria
BEA	Banque Extérieure d'Algérie
COSOB	Algerian Securities Commission
DA	Algerian Dinars
FRR	Revenue Control Fund
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
MENAFATF	Middle East and North Africa Financial Action Task Force
ONECC	L'Ordre National des Experts comptables, Commissaires aux comptes et Comptables agréés
SARL	Limited liability company
SH	Sonatrach, National Oil Company
SICAV	Open-ended investment fund
SME	Small- and medium-sized enterprise
SVT	Treasury Securities Specialists
WB	World Bank

EXECUTIVE SUMMARY

The Algerian financial system remains stable only because of public banks' ability to draw on government support when needed. The private banks are now all subsidiaries of reputable foreign banks and maintain a sound performance record and risk profile, despite operating in a difficult environment. However, these banks are relatively small, and government intervention is hampering the development of an efficient and competitive financial system.

Since 2003 Financial Sector Assessment Program (FSAP) assessment, efforts were made to reform the banking system, although progress remains slow in the public banking sector. Foreign bank entry has helped the sector, even if private banks represent less than 10 percent of total banking sector assets. This share would have risen to 18 percent with the completion of the privatization of *Crédit Populaire d'Algérie* (CPA), which is now on hold. The authorities have sharpened certain areas of banking supervision, such as the licensing process, although enforcement of key prudential regulations has proven difficult in public banks. The development of the corporate bond market is another noteworthy achievement. The reform of the payment system is now in the operational stage and should help modernize public banks' information systems. The authorities have by and large protected the economy from oil price fluctuations through prudent fiscal policy and consistent liquidity absorption by the central bank.

The system still faces significant challenges in meeting the needs of a growing economy. The priority is both to increase the efficiency of the banking sector and foster greater access for the private sector to bank and alternative sources of financing. At the same time, there is an overarching need to improve the environment in which the financial sector operates, while also addressing the problems posed to the financial system by the repatriation of oil export proceeds. Five courses of action should be considered.

Clarifying the role of the State in the banking sector

- The strategy regarding public banks, including a privatization timetable and the operational objective of the remaining public banks (e.g., specialized vs. universal, profit maximizing vs. required to meet specific social objectives, etc.), should be clarified and their governance structure should be strengthened accordingly. Unfortunately, in December 2007, the first privatization of a large state-owned bank—a key recommendation of the 2003 FSAP—was postponed until further notice in relation to deteriorating international market conditions.
- If some of these banks are asked to meet social policy objectives, these activities should be funded and remunerated through clearly specified budget allocations.

Creating a level playing field between private and public banks

- The authorities should refrain from granting special treatment to public banks, including repurchases of nonperforming loans, or other mechanisms that influence their day-to-day management decisions such as special schemes to finance public industrial projects