Chapter 13
Convergence of Banking Regulation

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13.1 Introduction

The SEMC reformed their financial sectors in the 2000s. We developed a number of indicators to track the evolution and assess the adequacy of banking regulations using publicly available and comparable surveys for a sample of countries since the early 2000s. To allow comparability across the Mediterranean, the report develops the measures for ten of the SEMC, all except Libya, and seven of the EU-MED.

We aimed to develop quantitative measures of regulatory development to assess convergence on international norms. In line with Ayadi et al. (2011a) and Ayadi and De Groen (2013), we identified seven areas of regulatory adequacy. These cover the definition of banking, licensing requirements, capital requirements, the independence and power of the supervisor, the presence of safety nets, disclosure, and the availability of credit information using distinct data sources. Several areas of study (i.e. payment and settlement systems, credit guarantee schemes, and financial inclusion) have been excluded due to the unavailability of comparable information sources for the sampled countries.

The analysis shows some levels of convergence in banking regulations in the region. The SEMC have improved credit information and capital requirements as well as reduced entry obstacles in 2000s. Nevertheless, they suffer from weaknesses in deposit insurance, entry obstacles, political interference, and insufficient legal rights.

The remainder of this chapter is structured as follows. Section 13.2 provides a description of the methods and data used to analyze the convergence of banks in the Euro-Mediterranean area. In Sect. 13.3, we present and discuss quantitative

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measures. Based on the results, conclusions and policy recommendations are drawn in Sect. 13.4.

13.2 Methodology

The main source of information for the regulatory adequacy indices are the BRSS developed by Barth et al. (2001), later revised in 2003, 2007, and 2011 (see Barth et al. 2006, 2008, 2012). All four surveys are built on responses to questionnaires sent to national regulatory and supervisory agencies of over 120 countries, most of which were returned. The questions cover a variety of areas, including banking activity, barriers to entry, capital regulations, supervisory authority, private monitoring, deposit insurance, and external governance.

One of the advantages of the BRSS is that the questionnaires have remained similar over the years. Later versions simply cover more subjects than the original survey. This feature of the dataset allows us to make comparisons by building composite indices. These indices, based on answers over time, track the evolution of regulation and supervision.

A disadvantage of the Barth et al. (2001) survey is that the number of questions responded to in the 2003, 2007, and 2011 revisions vary from one country to another. For Mediterranean countries, response rates are lower than for the entire sample. Among the SEMC, the Moroccan regulatory authorities were the most responsive, with an average response rate above 95 % (Fig. 13.1). The regulatory

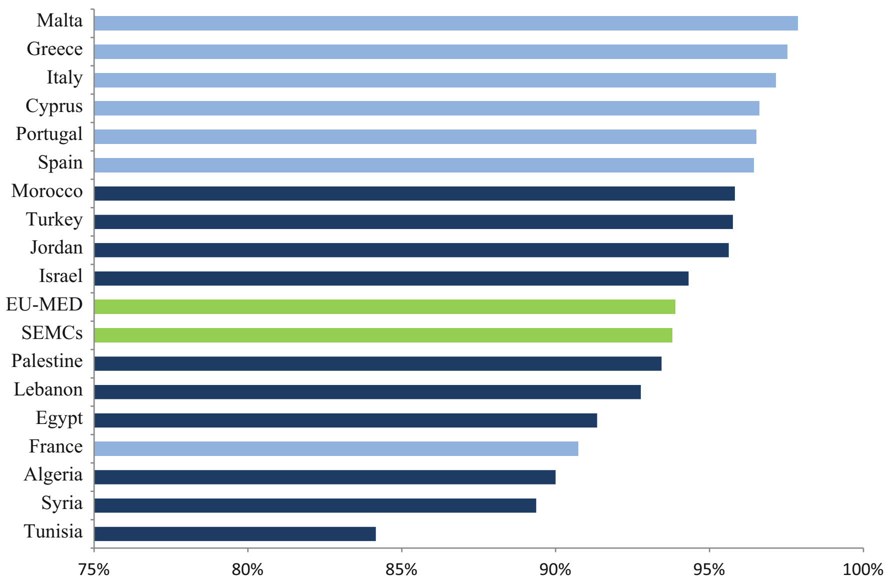

Fig. 13.1 Average response rates to the BRSS of Barth et al. (2006; 2012) (From BRSS) (Note: Response rates are averaged over the four surveys and correspond to the number of questions with complete answers divided by the total number of questions)

authorities of Algeria, Syria, and Tunisia had response rates of between 83 % and 90 %, below the Mediterranean average. Although the response rates appear high, the existence of a single partial or empty answer renders the construction of a relevant composite index dubious, since there is no way of scoring for missing responses.

Some of the SEMC have not responded to all four surveys. Palestine responded to one survey (2011), Algeria (2003, 2007), Syria (2007, 2011) and Tunisia (2003, 2011) to two surveys and Turkey (2000, 2003, and 2011) to three surveys. To avoid inconsistencies, empty answers were scored as zero in the construction of the relevant indices. This approach is in line with Barth et al. (2006, 2012). The assessment of regulatory convergence is based on the calculation of regional averages, weighted by the total banking assets of each country.

A second disadvantage of Barth et al. (2001) and its revisions is that the questions did not cover all regulatory and supervisory areas, such as the extent of credit information sharing and creditors' legal rights. We used additional sources to supplement the construction of the composite indices, including the deposit insurance database of Demirguc-Kunt et al. (2005), the IMF and WB Financial Sector Assessment reports, the WB DB indicators, and the websites of the national authorities.

13.3 Composite Indices

We created seven composite indices for each country and for the SEMC and EU-MED regions, using the data sources identified in Sect. 13.2: scope restrictions, entry obstacles, capital requirement stringency, supervisory authority, deposit insurance, private monitoring, credit information, and creditor rights.

13.3.1 Scope Restrictions

Across the world, financial institutions are becoming increasingly complex and offering a wider spectrum of products (Ayadi et al. 2011b). Some countries restrict banking to a narrow range of activities, such as taking deposits and issuing credit with little flexibility in debt and asset management, while others provide more flexibility. The rules typically restrict the extent to which banks may engage in the business of (i) securities underwriting, brokering, dealing, and all aspects of the mutual fund industry; (ii) insurance underwriting and selling; and (iii) real estate investment, development, and management.

The country-specific results show that regulators in the SEMC impose more restrictions than their counterparts in the EU-MED. The composite indicator used in this area is based on the BARI and constructed by summing up the scores for the WB Guide questions 4.1–4.3, as detailed in Barth et al. (2006). The surveys

measure the degrees of restrictiveness for each of the above three categories, ranging from unrestricted (1 point), mostly permitted (2 points) and too restricted (3 points) to fully prohibited (4 points). The BARI sums up the scores for each category, with a maximum restrictiveness score of 12, where no activity other than narrow banking is allowed.

An analysis of the survey results shows that on both coasts of the Mediterranean, regulators impose some restriction on insurance activities. Israel and Jordan's banks face restrictions on real estate activities and some prohibitions on securities and insurance activities. This is in line with Turkey, although Jordan's banks only have to deal with a few restrictions in order to engage in securities activities. Syria's banks, which are prohibited from engaging in both insurance and real estate activities, are free to engage in securities activities. Morocco's banks are similarly restricted in their activities, but are allowed to engage in insurance activities to a limited extent. Algerian banks are prohibited from engaging in insurance activities, but are free to engage in securities and real estate activities. Palestine's banks are free to engage in insurance activities and face fewer restrictions in both securities and real estate investment activities. Lebanon's banks are prohibited from engaging in real estate activities yet have a degree of freedom to engage in insurance and securities activities. Egypt imposes restrictions on insurance and real estate, comparable with the EU-MED. Information on Tunisia remains incomplete.

EU-MED banks face fewer restrictions than most of their neighbors. All EU-MED banks have freedom to engage in securities activities. Spanish, Portuguese, and Greek banks are relatively lightly restricted from engaging in insurance and real estate activities. Cypriot and Maltese banks are prohibited from engaging in real estate activities. French banks are prohibited from insurance.

There is a convergence tendency between the regional weighted averages. While the EU-MED weighted averages have gradually moved up over time, the SEMC averages have gone down, converging on the former.

Israel and Jordan impose numerous restrictions while Palestine has the most flexible system. Spain's system imposes the least number of restrictions while France and Malta have narrowed the scope of banking activities over the years. This EU-MED trend may change as a result of post-financial crisis reforms in the EU that increased restrictions on banking activities.

13.3.2 Entry Obstacles

Competitive conditions depend on regulations that hinder or prevent entry into the banking sector. Obstacles may take the form of excessive licensing or entry requirements, which are applicable to domestic and foreign banks alike. Governments may restrict entry of foreign banks as a policy choice, either explicitly by setting limits on ownership or implicitly by rejecting foreign applications in a disproportionate manner. Lastly, a banking sector that is predominantly

state-owned may be disadvantageous for privately owned banks.[1] These three indicators are used to construct the index of entry obstacles.

The first indicator is computed by summing up the scores for the WB Guide questions 1.8.1–1.8.8, as detailed in Barth et al. (2006). It reflects the total number of required documents, including (i) draft by-laws, (ii) an organizational chart, (iii) financial projections, (iv) financial information on potential shareholders, (v) the background of directors, (vi) the background of management, (vii) details of funding sources, and (viii) market differentiation intended. Both the SEMC and the EU-MED require all eight types of entry documents. Only Greece and Portugal do not legally oblige banks to provide information on the background of future managers.

The second indicator considers the discretionary power that the authorities enjoy by granting or rejecting entry. It shows the fraction of licensing applications for foreign banks that have been denied within the past 5 years from the day the survey was conducted (the WB Guide question 1.10, as detailed in Barth et al. 2006).

Denials of foreign banking applications are frequent in the SEMC, in contrast to the EU-MED, where they are rare. The Egyptian regulator denied all licensing applications of foreign banks between 1995 and 2002 and four out of the five applications between 2006 and 2010. Jordan denied two of the four applications over the same period. Turkey refused 2 out of 15 foreign applications. Israel and Morocco denied several foreign banking applications in the past, but none of five applications between 2006 and 2010. Algeria, Lebanon, Palestine, Syria, and Tunisia do not use denials of foreign bank applications as an entry obstacle. The percentage of foreign denials in the SEMC has decreased since 1995, suggesting some convergence with the EU-MED.

The third and last indicator on entry obstacles relates to government-controlled banking (the WB Guide question 3.8.1, as detailed in Barth et al. 2006; data are only available for the 2003, 2007, and 2011 surveys). This is a measure of the market power of state-owned banks, i.e. the percentage of total banking assets controlled by the banks in which government possesses more than 50 % of equity.

While the state has little control over banking in the EU-MED, except in Greece and Portugal, public sector banks represent a significant part of the banking activity in the SEMC. This is the case in Algeria, Egypt, and Syria. State-owned banks in these countries enjoy implicit or explicit state guarantees, have access to public funding, and are subject to less strict rules, putting potential entrants at a disadvantage and undermining competition (Barth et al. 2004).

Put together, the three indices provide a picture of the entry obstacles in the countries sampled. The set of documents needed for a valid licensing application

[1] Aside from their potentially negative impact on entry, state-owned banks may fulfil an important developmental role. Rocha et al. (2010) show that in the MENA region, public banks compensate for the low private bank involvement in the SME sector, engaging in more risky loan issuance, although they seem to have less than sufficient capacity to manage such risks. Andrianova et al. (2010) provide evidence that government ownership of banks is associated with higher long-run growth rates in developing countries.

are similar on both sides of the Mediterranean. These requirements are used to ensure that only ‘fit and proper’ undertakings are allowed to operate as banks. Only two countries, Greece and Portugal, distinguish themselves with few licensing requirements. Foreign entry denials – a less official form of control authorities exert on the banking sector – are high in some of the SEMC, particularly in Egypt and Jordan. Governments maintain direct controls over the banking sector in most of the SEMC. State-owned banks account for more than two-thirds of the banking sectors of Algeria, Egypt, and Syria. Although entry conditions appear comparable, there are significant and persistent entry obstacles that curtail competition in the SEMC’s banking sectors.

13.3.3 Capital Requirement Stringency

One of the aims of bank regulation is ensuring that banks operate soundly. Capital requirements are a part of these rules, which determine the minimum amount of capital a bank should hold relative to its total assets (or risk-weighted assets).

Capital ratios tell us how sound the banking sector is. All the countries have maintained a total capital ratio of between 9 % and 15 %, with the exception of Greece. Since 1998, banks in the SEMC have become better capitalized, with average capital ratios reaching 16.9 % towards at the end of 2010s. In 2011, capital ratios decreased to 15.5 %, especially in fast-growing banking sectors like that of Turkey.

Capital ratios in the SEMC are higher than in the EU-MED, which can reflect either the stringency of capital requirements or a lower appetite for risk.

This is addressed by the WB Guide questions 3.1.1, 3.2, 3.3, 3.9.1, 3.9.2, 3.9.3, and 1.5–1.7. The calculation of the index is detailed in Barth et al. (2006: 337–338). One question (3.7) on the fraction of revaluation gains allowed as part of capital has been omitted because the responses were not available for most of the countries in the sample. The index that determines the extent to which capital requirements restrict leverage potential and risky behavior, includes questions on (i) whether the minimum capital-to-asset requirements are in line with 1988 Basel Accord definitions; (ii) whether the minimum ratio varies with the bank’s credit risk or (iii) market risk; and whether the value of (iv) unrealized loan losses, (v) unrealized security losses or (vi) foreign exchange losses are deducted from regulatory capital. The index seeks to measure the restrictions imposed on the source of regulatory capital, such as (vii) whether these funds are verified by regulatory authorities; and, whether (viii) cash and government securities, or (ix) non-borrowed funds are the only forms of capital allowed for initial disbursements and subsequent injections. A greater number of positive responses to these questions leads to a higher stringency score.

The results reveal that capital requirements have become more stringent in most of the analyzed countries. More and more of the SEMC are implementing legislation to align their capital requirements with Basel II capital standards. Jordan,

Lebanon, Morocco, Syria, and Turkey adopted legislation that allowed banks to vary their minimum capital requirements depending on banks' individual credit risk and market risk. The implementation of this legislation led to a jump in capital stringency between 2007 and 2011 with the exception of Tunisia. The Tunisian authorities filled out fewer questions regarding capital stringency than 7 years earlier.

Among the EU-MED, Cyprus had the most stringent capital requirements, with affirmative answers to six out of seven questions in 2011, followed by France and Spain. Like other EU-MED, the Cypriot supervisory authorities did not verify the sources of funds to be used as capital. France and Spain strengthened the rules. During the financial crisis, capital requirements in these countries were relaxed: banks could increase their capital with assets other than cash or government securities. The initial capital of banks in Greece, Italy, and Malta could include borrowed funds. Banks in Portugal were not obliged to deduct unrealized losses in securities portfolios from capital and were allowed to fund capital contributions using assets other than government securities or cash.

There is a pattern of convergence. EU members Greece, Italy, Malta, and Portugal have flexible capital requirements, while the opposite is true for Cyprus, France, and Spain. The capital requirements of most of the SEMC are more stringent than EU-MED averages, especially concerning the usage of non-cash or government securities and borrowed funds for capital. These results are in line with findings of Tahari et al. (2007).

13.3.4 Supervisory Authority

Supervisory authorities are judged based on their powers to discipline or, at the extreme, resolve banks that violate their rules or engage in imprudent activities. Two indices are used to measure supervisory authority power.

The first one measures the power of the supervisor to take actions to correct or prevent problems. Its calculation is detailed in Barth et al. (2006: 339–342) and based on the WB Guide questions 5.5–5.7, 6.1, 10.4, 11.2, 11.3.1–11.3.3, 11.6, 11.7, and 11.9.1–11.9.3. They address the ability of supervisors to (i) meet external auditors without the approval of a bank, (ii) communicate directly with auditors on illicit activities undertaken by a bank's management or directors, (iii) receive disclosure of off-balance sheet items, (iv) take legal action against negligent auditors, (v) change the organizational structure of a troubled bank, (vi) order management or directors to cover losses, and (vii) suspend dividend distributions, as well as (viii) bonuses and (ix) management fees. Additionally, for the 2003, 2007, and 2011 surveys, questions on troubled banks considered the supervisors' ability to (x) declare insolvency, (xi) suspend ownership rights, (xii) supersede shareholder rights, and (xiii) fire or hire management or (xiv) directors. An affirmative answer to any of these questions means greater supervisory power. Some of these powers may only be exercisable by supervisory-like institutions, such as a

depository insurance agency or a bank restructuring agency. In these cases, the aggregate score is augmented by only half points.

The results suggest that the SEMC and the EU-MED grant more or less the same power to their supervisory authorities. Yet there are differences among individual countries. In Jordan and Palestine, the supervisor is allowed to intervene directly in all the domains highlighted above. The supervisor in Syria has only elementary tools, like the possibility to meet external auditors without the approval of the bank, but is not allowed to communicate directly with auditors on illicit activities or take any legal action against these auditors. The supervisor can prevent dividends being paid out, but cannot suspend bonuses for management. As in all of the SEMC, excluding Jordan and Palestine, the Syrian supervisor does not have the authority to declare a bank insolvent or supersede shareholder rights.

Cyprus, France, Italy and, to a lesser extent, Portugal and Spain grant substantial power to their supervisory authorities. Greece obtains the lowest score in supervisory power: its supervisory authority has no right to meet external auditor without prior approval of the bank or to sue the auditors for negligence. Greek banks are not obliged to publish information on off-balance sheet positions. Furthermore, the Greek supervisor does not have power to suspend shareholder rights or replace management.

The second measure of supervisory authority is independence from political influence. Three questions are considered (WB Guide questions 12.2, 12.10, and 12.2.2 – see Barth et al. 2006: 349–350): (i) Are supervisory bodies accountable *only* to a legislative body? (ii) Are supervisors legally liable for their actions committed in the exercise of their duties? (iii) Does the head of the agency have a fixed term? The level of independence is determined based on affirmative answers to questions (i) and (iii) and a negative answer to (ii).

The results show a divergence. Banking supervisors in the EU-MED have become more independent. Far less has changed in the SEMC, where supervisors remain directly accountable to the executive branch of government, i.e. the president, the king in case of Morocco, the prime minister, or other cabinet members.

Of concern is Algeria, where none of the criteria was satisfied in the last available survey, which implies enormous potential for political interference. The same can be said of Israel, Lebanon, Morocco, and Syria. In comparison, the supervisor is only accountable to a legislative body in all EU member states except Greece and Italy, as well as in Egypt, Jordan, Palestine, Tunisia, and Turkey. The Italian supervisory authority's independence remains below EU standards, as does its legal liability for damages to a bank in the exercise of its duties. A fixed term for the head of the regulatory authority does not exist in Algeria, Israel, Morocco, or Syria, but has become popular in the EU.

The results of the BRSS surveys show that the powers granted to supervisors have increased or remained constant in almost all countries. They are on the rise on both sides of the Mediterranean. Government officials retain the ability to interfere in supervisors' work. Provided that some of the SEMC have a substantial government presence in the banking sector (see Sect. 13.3.2), operational

independence should be a guiding principle to ensure that all banks – publicly- or privately-owned – are treated equally.

13.3.5 Deposit Insurance

Deposit insurance systems are designed to prevent disruptions to financial markets. They provide confidence to small depositors and prevent bank runs. At the same time, they create moral hazard, diminishing depositors' incentives to monitor and screen banks and amplifying banks' incentives to take on excessive risk at the cost of deposit insurance funds and, ultimately, taxpayers.

The deposit insurance index computed for 2003, 2007, and 2011 identifies the level of observance of standards that are thought to mitigate the moral hazard problem. Its calculation follows the proposal of Barth et al. (2006: 354) and uses information provided by BRSS, Demirguc-Kunt et al. (2005), the European Commission (2010), and documents from the websites of Bank Al-Maghrib and Banque d'Algérie.

For countries with an explicit system, three issues are important: (i) whether a co-insurance discount is applicable to pay-outs,[2] (ii) whether premiums are risk-adjusted and (iii) whether only banks take a primary role. An additional point is scored for an affirmative answer to each one of these questions. A score of zero is assigned to countries with no explicit deposit insurance system. In such cases the government is assumed to provide implicit guarantees, creating an incentive for banks to take excessive risks.

The scores show that moral hazard is a problem in the SEMC due to the absence of explicit deposit guarantee schemes in Egypt, Israel, Palestine, Syria, and Tunisia. The Algerian system was equivalent to an implicit guarantee with the government providing direct funding until 2003, when this system was replaced with full funding by banks.

Among countries with explicit systems, Algeria, Cyprus, Spain, Greece, Jordan, Lebanon, Malta, and Morocco only satisfied the requirement that the banks (and not the government) play the primary role in deposit insurance funding in 2011. The French, Greek, Italian, and Portuguese systems included risk-adjusted premiums, impacting the EU-MED averages. Lastly, the EU-MED averages display a downward trend due to the gradual abandonment of co-insurance payouts. The European Commission (2010) proposal to harmonize deposit guarantee schemes in the EU would oblige EU member states to implement a risk-based, deposit guarantee scheme that is bank-funded. The proposal has not been adopted, since the European Parliament and Council have not agreed on the final terms.

[2] Empirical evidence shows that the coverage limits and co-insurance practices serve to reduce the likelihood of bank failure substantially (Demirguc-Kunt and Detragiache 2002).

Egypt,[3] Israel, Palestine, Syria, and Tunisia do not have active deposit insurance schemes, albeit each country is studying or considering implementing one. A badly designed scheme invites additional risks and may be no better than no scheme at all. The results show that schemes in Jordan, Lebanon, and Morocco, as well as in some of the EU-MED countries, amplify moral hazard risks. Still, these conclusions should be interpreted with care. As the recent global financial crisis has shown, when a run on a bank has the potential to spur broader panic, a government is likely to step in to stop a bank run, regardless of explicit arrangements in place.[4] Named arrangements may not mitigate moral hazard, since they are easily replaced with limitless state support. Such blanket guarantees are not viable in most of the SEMC, which have limited public resources. The explicit schemes, wherever they exist, are the only viable insurance for depositors, highlighting the importance of design issues in resource-poor countries.

13.3.6 Private Monitoring

There are other forces that influence banks. Investors shape banks' decisions and restrain risky behavior. Theoretically, block-holders can exercise their voting power to influence managerial actions. More realistically, creditors or stockholders use available information to assess a bank's condition and indirectly influence the management by withdrawing funds, which has an impact on the borrowing costs of the bank. Private monitoring is undermined when an explicit and over-generous scheme for deposit insurance exists. The availability of reliable and timely information for investors is at the core of market discipline.

The private monitoring index is based on responses to the WB Guide questions 5.1, 5.3, 10.7.1–2, 10.1, 10.1.1, 10.3, 10.6, 3.5–6, 10.4.1, 10.5, and 11.1.1. As compared to Barth et al. (2006), we exclude a question on the presence of an explicit deposit insurance, which has been covered in Sect. 13.3.5. The questions concern whether (i) a certified audit is required and whether all of the top ten banks are rated by (ii) domestic or (iii) international credit rating agencies. They consider whether income standards include accrued but unpaid interest on (iv) performing or (v) NPL; (vi) banks are required to produce consolidated accounts; (vii) directors are liable for erroneous or misleading reporting; (viii) subordinated debt is allowable or required as part of capital; (ix) off-balance items are disclosed to the public; (x) banks are required to disclose risk-management procedures and (xi) supervisors are required to make enforcement actions public. The private monitoring score increases with affirmative answers to these questions.

[3] In Egypt, although the legal framework allows for the establishment of an autonomous deposit insurance fund, no scheme has been set up yet.

[4] The example of the fall of Northern Rock in 2007, when the UK Treasury extended the existing guarantees – with a maximum payout of GBP31,700 at the time – to cover all deposits.

The comparison points at a small but growing disparity between the two coasts of the Mediterranean. Although most countries fulfill a majority of the requirements, the progress in the EU is not paralleled in the SEMC. The difference between the SEMC and the EU-MED is the share of the top ten banks that are rated by international or domestic credit rating agencies. This gap has widened according to the 2011 survey. In the EU, almost all of the top ten banks are rated by credit rating agencies, except in Cyprus and Malta. In the SEMC, most banks are not rated. In some cases this is due to the structure of the market (a small or highly concentrated banking sector). Algeria's largest banks are state-owned and as of 2007 they were not subject to ratings. In other countries, there are problems with disclosure. In three of the most developed markets in the region, Israel, Lebanon, and Morocco (2007 survey), only half of the top ten banks are rated.

Another issue is the exclusion of accrued (though unpaid) interest from income statements, which allows banks undue flexibility in determining their earnings. Lastly, according to the 2011 BRSS, Tunisian banks are not required to make their risk management procedures public, despite this requirement becoming standard in the region in recent years. Regulatory structures in the SEMC have not matched the progress made in the EU-MED on disclosure rules.

13.3.7 Credit Information and Creditor Rights

Access to information and laws on creditor protection are crucial for the smooth operation of credit markets. Economic theory suggests two limits to the amount of credit that financial institutions can grant to potential borrowers. On the one hand, credit conditions are bound by the ability of creditors to enforce contracts, require repayment, claim collateral, and gain control over receivables. The easier these actions are, the more likely that lenders will grant loans. On the other hand, lenders would like to have access to accurate information on potential borrowers, such as credit histories, other lenders, and other banking transactions.

Theoretical models suggest that information-sharing infrastructure can reduce adverse selection in credit markets and facilitate access to credit, especially among more opaque borrowers, such as SME (Pagano and Jappelli 1993). When such information is available, creditors can make a better judgment of borrowers' creditworthiness. Other papers have documented the importance of creditors' rights for the availability of credit (La Porta et al. 1998; Levine 1998). Recent studies have confirmed these views with evidence that both credit information mechanisms and creditors' rights have an impact on the flow of credit and financial development (Jappelli and Pagano 2002; Djankov et al. 2007; Haselmann et al. 2010).

The indices on credit information and laws developed in this section are based on the 'Getting credit' methodology of the WB DB surveys.[5] They cover the legal

[5] See http://www.doingbusiness.org/methodology/getting-credit

rights of borrowers and lenders with respect to secured transactions and the extent of credit information sharing.

The first index describes how well collateral and bankruptcy laws facilitate lending, i.e. (i) the ability to use moveable assets while keeping possession of assets and the ability to obtain non-possessory security rights in (ii) a single or (iii) all moveable asset classes without requiring a specific description of the collateral. It covers (iv) the extension of security rights to future or after-acquired assets; (v) the ability to secure all types of debts and obligations through a general description; and (vi) the availability of a collateral registry. In addition, it looks at the ability of secured creditors to obtain priority without exceptions in the case of (vii) defaults, (viii) liquidations and (ix) restructuring; and (x) the possibility of out-of-court agreements on collateral enforcement. An affirmative answer to any one of these questions enhances the relevant scores.

The results show that fewer legal rights are granted to creditors in the SEMC. Israel does well, better than almost all countries, by satisfying all but one criterion on the availability of out-of-court agreements on collateral enforcement. Among the EU-MED, Cyprus does equivalently well, complying with all but one criterion, regarding secured creditors' claims during reorganization. France and Spain perform well. Other countries, including the SEMC, do badly, complying only with the criteria on the use of movable assets as collateral, the ability to grant non-possessory rights for a group of assets, and the use of debts in collateral agreements.

The second index measures the availability, coverage, and depth of credit information, either through public credit registries or private credit bureaus. The questions relate to the (i) collection of both positive and negative information, (ii) collection of data on firms and information, (iii) collection of data from retailers and utility companies, (iv) availability of credit history for at least 2 years, (v) availability of data on small loans (i.e. less than 1 % of annual incomes) and (vi) ability of borrowers to access their credit history. As above, an affirmative answer to any one of these questions leads to an additional score.

The SEMC have closed the gap with the EU-MED in terms of the depth of credit information. The average score of the SEMC in the last survey was higher than the score of their EU-MED counterparts. In recent years, credit bureaus in Algeria, Egypt, Morocco, Palestine, and Tunisia have improved their information. In a recent WB DB survey, Egypt satisfied all of the six criteria. Credit bureaus in Lebanon, Morocco, Tunisia, and Turkey only failed to satisfy the criterion to collect data from retailers and utility companies. The credit bureau in Israel met five of the criteria, but did not report both positive and negative credit information. Jordan and Syria are outliers: their credit bureaus only met two criteria.

Among the EU-MED, Cyprus and Malta are exceptions with low scores. In Cyprus, the private credit bureau only meets two criteria and in Malta there is no credit bureau at all. Other EU-MED countries comply with almost all of the criteria. Like many of their SEMC counterparts, French, Greek, Italian, and Portuguese credit registries do not collect information from retailers or utility companies. French credit bureaus do not provide both positive and negative information.

Spanish bureaus do not distribute historical credit information of more than 2 years, but meet all the other criteria.

The figures show that reforms have helped the SEMC to close the gap with the EU-MED in using credit information. The same cannot be said on the strength of legal rights; the EU-MED's average is higher than that of the SEMC.

13.4 Conclusions

This section provides a summary of the seven dimensions analyzed in Sect. 13.3. Figures 13.2 and 13.3 and Table 13.1 show the weaknesses that distinguish the SEMC from the EU-MED: deposit insurance, entry obstacles, strength of creditor rights, potential for political interference, and private monitoring.

The deposit insurance index has failed to improve in recent years because Egyptian, Israeli, Palestinian, Syrian, and Tunisian authorities have chosen not to put explicit insurance schemes in place. Implicit schemes, blanket government guarantees for leading institutions, may enhance risk-taking. In Algeria, Jordan, Lebanon, and Morocco, no effort has been made to align banks' incentives by implementing risk-based premiums or co-insurance schemes, which would help internalize some of the costs to the deposit guarantee schemes that stem from excessive risk-taking.

Entry obstacles remain a weakness in the region. Although licensing requirements are similar on both shores of the Mediterranean, other indicators point at

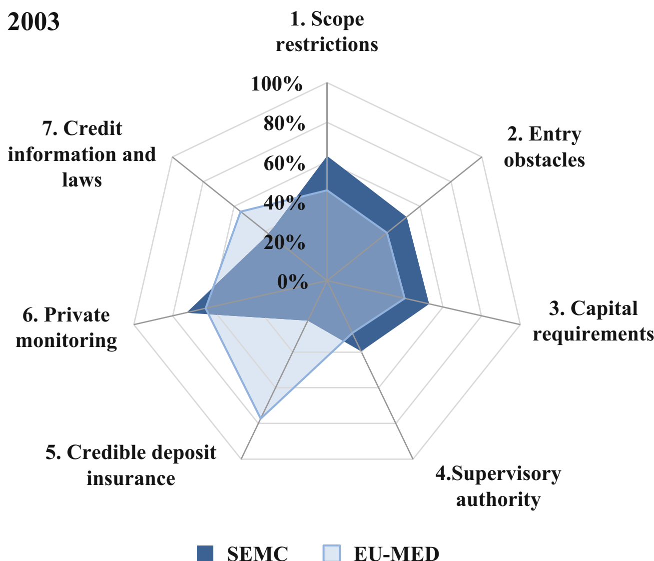

Fig. 13.2 Regulatory standards in the SEMC and EU-MED region, 2003

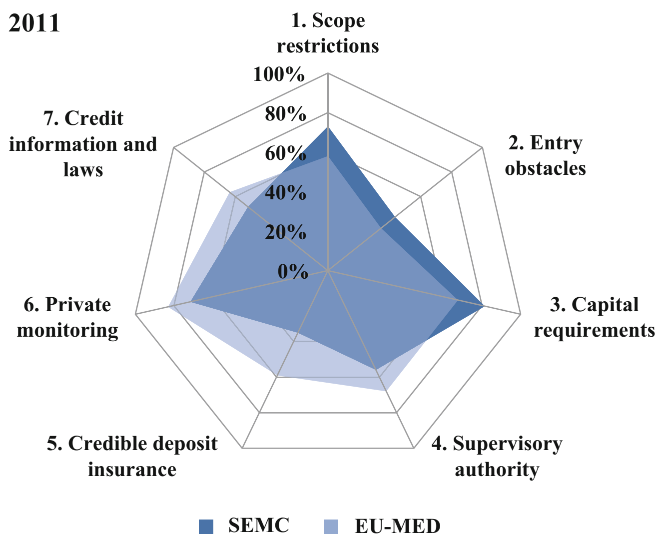

Fig. 13.3 Regulatory standards in the SEMC and EU-MED region, 2011 (Note: Figs. 13.2 and 13.3 sum up the SEMC and the EU-MED weighted averages for the regulatory indices in each of the seven areas)

substantial barriers to entry. State ownership, widespread in Algeria, Egypt, Syria, and, to a lesser degree in Morocco, Tunisia, and Turkey, gives undue advantages to incumbent banks and restricts entry incentives. Although public ownership may offer some benefits (see Sect. 13.3.2), the authorities have to ensure that such roles are defined within a national strategy with clear objectives and instruments, and that they do not hinder the development of the financial system. Rates of foreign denials are high, confirming the entry barriers and competitive advantages enjoyed by domestic incumbent banks.

The 2011 survey points at new concerns. First, poor accounting practices have contributed to a disparity in private monitoring indices. Second, political interference has become a problem, potentially reinforcing the governments' direct control, undermining supervisory authority and, as result, the competitiveness and efficiency of the banking sector (see Chap. 12). As the eruption of public discontent in Tunisia and Egypt in early 2011 attests, the region's governments have attempted to maintain a tight grip on their countries' political and economic systems for far too long. Such forms of interference conflict with the objectives of financial and competition authorities.

On the other hand, the SEMC have implemented reforms to improve the availability and use of credit information by financial institutions. Egypt and Morocco established private credit bureaus in 2006 and 2009, respectively. The SEMC's average is now above the EU-MED's average. Algeria, Israel, Jordan, Lebanon, and Tunisia continue to rely on public registries, three of them meeting all the criteria except collecting credit information on retail stores or utility companies.

Table 13.1 Summary of regulatory weaknesses in the SEMC (Authors' analysis)

Area	Description	General remarks	Algeria	Egypt	Israel	Jordan
I. Scope restrictions	Restrictions on or prohibition of various activities	Slightly more stringent than EU-MED standards	Some restrictions on real estate; insurance activities prohibited	Some restrictions on insurance and real estate	Some restrictions on securities trading and insurance; real estate activities prohibited	Some restrictions on securities trading and insurance; real estate activities prohibited
II. Entry obstacles	Licensing, foreign entry and presence of public banks	Below EU-MED standards due to foreign denials and the role of government	Public banks represent >90 % of bank activity	Foreign denials; public banks represent > 60 % of bank activity		Foreign denials
III. Capital requirements	Extent to which capital requirements restrict risks	More stringent capital requirements than the EU-MED		Market risks not considered		
IV. Supervisory authority	Ability of supervisors to prevent and correct problems	Below EU-MED standards and potential for political interference	High potential for political interference	Some potential for interference	High potential for political interference	Some potential for interference
V. Deposit insurance	Presence of an explicit scheme and mitigation of moral hazard	Below EU-MED standards due to the implicit insurance and adverse incentives	No co-insurance or risk-adjusted premiums	No explicit deposit insurance scheme	No explicit deposit insurance scheme	No co-insurance or risk-adjusted premiums
VI. Private monitoring	Availability of reliable and timely information to investors	Increasing disparity due to few rated banks and flexibility in accounting	Top banks not rated; flexibility in accounting	Several top banks not rated	Several top banks not rated	Several top banks not rated
VII. Credit info. and creditor rights	Ability of legal and information systems to facilitate lending	Below EU-MED standards due to deficient legal rights	No private credit registry; limited legal rights for creditors	Limited legal rights for creditors		No private credit registry; limited legal rights for creditors

(continued)

Table 13.1 (continued)

Area	Lebanon	Morocco	Palestine	Syria	Tunisia	Turkey
I. Scope restrictions	Real estate activities prohibited	Some restrictions on insurance; real estate activities prohibited		Insurance and real estate activities prohibited	Some restrictions on securities and insurance	Some restrictions on insurance; real estate activities prohibited
II. Entry obstacles	Public bank activity	Foreign denials		Public banks represent >70 % of bank activity	Public banks have a diminishing role	Foreign denials; Public banks represent >30 % of bank activity
III. Capital requirements	Broad definition of capital			Broad definition of capital		
IV. Supervisory authority	High potential for political interference	Some potential for interference	Some potential for interference	High potential for political interference	Some potential for interference	Some potential for interference
V. Deposit insurance	No co-insurance or risk-adjusted premiums	No co-insurance or risk-adjusted premiums	No explicit deposit insurance scheme	No explicit deposit insurance scheme	No explicit deposit insurance scheme	No co-insurance
VI. Private monitoring	Several top banks not rated	Several top banks not rated; flexibility in accounting	Several top banks not rated	Several top banks not rated	Flexibility in accounting rules; no risk management disclosure	Flexibility in accounting
VII. Credit info. and creditor rights	No private credit registry; limited legal rights for creditors	Limited legal rights for creditors	No private credit registry; barely any legal rights for creditors	No private credit registry; barely any legal rights for creditors	No private credit registry; limited legal rights for creditors	Limited legal rights for creditors

The same applies to Turkey, which has both public and private credit bureaus. Private credit bureaus have access to new technologies and know-how to ensure that information-sharing mechanisms work. The SEMC should continue to monitor developments and spearhead innovative systems to use the information and infrastructure set up by the public systems. Morocco serves as an example, combining the data collection roles and capacities of the Bank Al-Maghrib, which operates the public registry, with the newly established private credit bureau, Experian-Morocco (Madeddu 2010: 21–23).

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