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Ghana: Financial System Stability Assessment Update, including Reports on the Observance of Standards and Codes on the following topics: Banking Supervision, Insurance Regulation, and Securities Regulation

This Financial System Stability Assessment Update on **Ghana** was prepared by a staff team of the International Monetary Fund and the World Bank as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **November 26, 2003.** The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of **Ghana** or the Executive Board of the IMF.

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GHANA

Financial Sector Stability Assessment (FSSA) Update

Prepared by the Monetary and Financial Systems and African Departments

Approved by Stefan Ingves and Abdoulaye Bio-Tchané

November 26, 2003

This Financial Sector Stability Assessment (FSSA) is an update to the work of the FSAP team of 2000–01. The findings and conclusions are based on the FSAP update work of an IMF-World Bank mission that visited Accra from June 30 to July 15, 2003. It also draws on the work of the IMF and the World Bank in the intervening period.

- Ghana's economic situation has improved since the initial FSAP visit. The overall improvement in the macroeconomic conditions is creating a more propitious environment for the banks to begin to recover from the fallout of the macroeconomic instability that was present at the time of the FSAP.

- The key vulnerabilities that continue to confront the system at this stage are one large systemically important bank's excessive exposure to Tema Oil Refinery, the high level of past-due loans in the banking system, and government interference in the funding and investment decisions of the social security fund.

- Progress since the FSAP, in addressing identified development issues, has been limited. The financial sector continues to be underdeveloped and only services a small portion of the population. Banking competition appears to be weak, and an opportunity to increase competition was lost when the government suspended the planned divestiture of Ghana Commercial Bank. Given the importance of financing for SMEs, the mission underscored the need to: (i) improve corporate governance and financial reporting for Ghanaian firms; (ii) introduce a suitable legal framework to facilitate the operation of credit reference bureaus; (iii) address the inadequacies identified in property titles and weak judicial enforcement of foreclosure processes; and (iv) ensure timely payment of the government's obligations.

- A large number of new legislative bills has been drafted to significantly enhance the financial sector regulatory framework. However, this has been a slow process, which has hindered efforts to improve supervisory practices.

- The authorities were encouraged to seek passage of the Money Laundering Bill and obtain further technical assistance on AML/CFT issues to help develop and implement the needed infrastructure in this area.

The author of this report is Mark Zelmer (MFD).

FSAPs are designed to assess the stability of the financial system as a whole and not that of individual institutions. They have been developed to help countries identify and remedy weaknesses in their financial sector structure, thereby enhancing their resilience to macroeconomic shocks and cross-border contagion. FSAPs do not cover risks that are specific to individual institutions such as asset quality, operational or legal risks, or fraud.

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GLOSSARY

AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
GC	Ghana cedi
GCB	Ghana Commercial Bank
GSE	Ghana Stock Exchange
HFC	Home Finance Company
IAIS	International Association of Insurance Supervisors
IOSCO	International Organization of Securities Commissions
NIC	National Insurance Commission
NPLs	Nonperforming loans
OLEMs	Other loans especially mentioned
SEC	Securities and Exchange Commission
SIAA	Securities Industry Amendment Act
SIC	State Insurance Company
SME	Small-and medium-sized enterprises
SSNIT	Social Security National Insurance Trust
TOR	Tema Oil Refinery

I. Summary of Findings[1]

1. **Progress since the FSAP has been limited—the financial sector continues to be underdeveloped and only services a small portion of the population.** While the sector has the potential to become an effective and efficient supplier of financial services, it is currently held back by a broad array of problems and inefficiencies. The authorities have drafted an impressive list of new legislative bills that would provide a more modern framework for financial sector regulation, thereby helping to set the stage for further development of the sector. However, this has been a slow process, which has hampered efforts to introduce more effective financial sector supervision such as tighter enforcement of prudential regulations in the banking system.

2. **The main vulnerabilities in the financial sector can be found in the banking system and the social security fund (SSNIT).** The most important ones in the banking system are the exposure of one large systemically important bank to the Tema Oil Refinery (TOR) and the high level of past-due loans in the system. If the government's economic program is successful and interest rates continue to decline, bank profit margins may come under pressure, which could make it more difficult for them to carry their large stock of past-due loans. In addition, a successful economic program could result in an expansion of bank lending to the private sector, implying the need for banks and their supervisors to ensure that credit risks on bank balance sheets are prudently managed. As for SSNIT, weak governance arrangements have plagued its investment performance in the past, and continued government interference in its funding arrangements and investment decisions could further undermine its weak financial position.

3. **The Ghanaian financial sector is also confronted by a large number of development challenges.** Competition in the banking sector appears to be weak, and banks need to overcome several major obstacles before they can expand lending to small and

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[1]The IMF and the World Bank visited Accra in July 2003 to update the findings of the 2000-01 FSAP. This update reviews developments in the financial sector since the FSAP, and presents factual updates of progress in implementing the recommendations put forth in the assessments of the *Basel Core Principles for Effective Banking Supervision*, the *IAIS Insurance Core Principles*, and the *IOSCO Objectives and Principles for Securities Regulation.* It also draws on the findings of an IMF mission to Accra in May 2003, which took stock of the country's access to long-term foreign private capital, including bank financing, and an overlapping World Bank technical assistance mission.

The mission was led by Messrs. Tony Thompson (World Bank, Head) and Mark Zelmer (IMF, Deputy Head), and included Kofi Boateng-Agyen, Serap Gonulal, Olivier Hasler, Roy Karagola, Walter Zunic (all World Bank); and Johan Mathisen (IMF). The team worked very closely with an overlapping World Bank technical assistance mission.

medium-sized borrowers and provide more housing finance. Moreover, the government's planned divestiture of Ghana Commercial Bank (GCB) has been suspended due to public concern about the potential foreign domination of Ghana's banking sector, and the attendant risk that the interests of ordinary Ghanaians could be overlooked. As for other sectors, the insurance industry and financial markets are undeveloped and have yet to play a meaningful role in intermediating medium– to long–term funds for the economy. To develop the financial sector, and given the importance of financing for SMEs, the authorities could: (i) improve corporate governance and financial reporting for Ghanaian firms; (ii) introduce a suitable legal framework to facilitate the operation of credit reference bureaus; (iii) address the inadequacies identified in property titles and weak judicial enforcement of foreclosure processes; and (iv) ensure timely payment of the government's obligations.

4. **The factual updates of Ghana's observance of the three international standards and codes illustrate the limited progress that has been achieved on the regulatory and supervisory front.** Progress has been most evident in securities regulation, where the SEC has continued to update its regulations following the passage of the SIAA in 2000. In contrast, the more limited progress in the banking and insurance supervision areas partly reflects delays in the drafting and passage of new legislation for these areas.

5. **The authorities were encouraged to seek further technical assistance on AML/CFT issues.** Staff encouraged the authorities to pursue passage of the Money Laundering Bill, and seek technical assistance from the IMF or World Bank to develop and implement the needed infrastructure in this area.

Table 1. Ghana: Progress in Implementing Key FSAP Recommendations

Principal Recommendations	Progress Achieved
Banking supervision	
• Reduce exposures of the two banks that still had claims on TOR to within prudential limits.	• Most TOR exposures converted into government securities in 2001 and 2002. However, on-balance sheet exposures for one large bank tripled in the first eight months of 2003 and are now well in excess of that bank's capital. That bank also has large and growing off-balance sheet exposures to TOR.
• Review banks' risk management approaches, and take remedial actions as needed.	• Risk management approaches reviewed, and three banks closed in 2000. However, enforcement of prudential regulations continues to be weak.
Insurance supervision	
• Introduce updated insurance legislation, addressing the need to reinforce the powers of the National Insurance Commission.	• New legislation has been drafted.
• Strengthen supervisory practices, including: inspection powers; prudential reporting; and mechanisms to liquidate weak insurance companies.	• Five insolvent companies closed despite out-of-date legislation. A task force was established in 2003 to improve prudential reporting and conduct regular on-site inspections.

Table 1. Ghana: Progress in Implementing Key FSAP Recommendations (concluded)

Principal Recommendations	Progress Achieved
Pension system	
• Continue efforts to reform SSNIT, including: develop clear written investment policies for SSNIT; improve its governance structures; and improve its procedures for the preparation of audited financial statements using transparent standards for valuation of investments, provision, and income recognition.	• Appointment of a new Board and a new director has helped to bolster SSNIT's independence. However, the government continues to interfere in its funding arrangements. • Investment policies and auditing procedures still need to be improved.
Securities regulation	
• Fully implement recently adopted securities legislation.	• Done.
• Concentrate oversight of all securities activities, including in treasury bills, in the Securities Exchange Commission (SEC).	• SEC still lacks authority over government securities.
• Introduce higher capital requirements, as well as position and foreign exchange exposure limits for securities companies.	• Done.
Legal and judicial system	
• Introduce a strong legislative framework against money laundering.	• Legislation has been drafted.
• Improve the effectiveness of the rules on contract enforcement, security, and collateral foreclosure, and the effectiveness of court procedures.	• No change.
Bank of Ghana	
• Reinforce the independence of the Bank of Ghana in the new central bank law.	• Done.
• Reinforce the focus on key central bank responsibilities.	• Done.
• Set a schedule for withdrawing from developmental policy and commercial financial activities.	• Done.
• Reinforce the transparency of financial reporting and the independence and quality of its audit.	• Significant progress achieved.
• Separate debt management from liquidity management, and develop a debt management strategy.	• Technical support being provided by USAID to help the Ministry of Finance establish a debt management office and introduce a more formal borrowing strategy.
• Strengthen the Bank of Ghana's capital by replacing government receivables with treasury bills and longer-term government securities.	• No change.
• Liquidate its ownership in banks.	• Done, except for shares in Ghana International Bank (London).

Source: Ghana Financial System Stability Assessment (2001).

II. Financial Sector Stability Issues

A. Macroeconomic Environment

6. **At the time of the FSAP, Ghana was hard hit by domestic macroeconomic imbalances, especially in the fiscal area, and severe terms of trade shocks**. This led to a very sharp depreciation of the exchange rate and high inflation (Table 2). However, substantial progress has been achieved in restoring macroeconomic stability in Ghana following the introduction of the PRGF program in 2001. Tighter control over government expenditures and high real interest rates helped to bring inflation down from 42 percent in March 2001 to 21 percent by end-2001, and 15 percent at end-2002. The cedi depreciated by almost 15 percent against the U.S. dollar during 2002, broadly in line with inflation. Gross international reserves recovered to nearly two months of imports despite a shortfall in donor financing. Real GDP growth in 2002 was an estimated 4.5 percent, stimulated by a sharp improvement in the terms-of-trade and more rapid real growth in credit to the private sector (from 12 percent in 2001, to 18 percent in 2002).

7. **Towards the end of 2002, however, slippages emerged in the implementation of the economic program.** This reflected weaknesses in public expenditure control, the failure to implement the program’s key revenue measure, delays in the divestiture plan, and a failure to adjust petroleum prices. Large government expenditures, larger-than-expected inflows of foreign exchange from the prefinancing of the cocoa crop, and a large increase in petroleum prices in early-2003 contributed to rising inflation pressures, as evidenced by an increase in the inflation rate to 30 percent in April 2003. This prompted the central bank to raise its prime interest rate twice by a total of 3 percentage points (to 27.5 percent) and to step up open market operations to withdraw liquidity. Inflation subsequently declined to 28 percent in August, and interest rates have followed suit.

8. **The high degree of uncertainty engendered by Ghana’s history of expansionary fiscal policy and high inflation continues to play a role in undermining the functioning of the financial sector.** It discourages borrowers and investors alike from undertaking medium to long-term commitments. As a result, markets for medium to long-term debt and equity capital and institutions specializing in this area are highly underdeveloped, and even the government has found it difficult to find investors willing to invest in treasury bills with maturities in excess of 91 days. Moreover, many commercial and rural banks’ ability to manage credit risk has eroded over time given the attraction of investing their funds in low-risk high-yielding short-term assets such as treasury bills, which in recent years have often offered high real rates of return. This has made it difficult for them to justify investing in the resources and infrastructure needed to seek out lending opportunities in other parts of the economy—such as the small- and medium-sized business sector—and keep their risk management practices up to date.

Table 2. Ghana: Selected Economic and Financial Indicators, 1997–2002
(End-of period, unless otherwise specified)

	1997	1998	1999	2000	2001	Est. 2002
	(Percentage change, unless otherwise specified)					
Real sector						
Real GDP growth	4.2	4.7	4.4	3.7	4.2	4.5
GDP (in billions of cedis)	14,113	17,296	20,580	27,15 3	38,071	48,862
Inflation rate	27.9	14.6	12.4	25.2	32.9	14.8
	(Percentage change, unless otherwise specified)					
Monetary and credit data						
Broad money (M3) (excluding foreign currency deposits)	44.3	20.2	19.8	33.4	48.4	50.0
Reserve money (excluding foreign currency deposits)	...	...	35.8	52.6	31.3	42.6
Net domestic assets 1/	33.2	15.9	46.0	49.1	13.5	13.7
Credit to government 1/	23.2	49.9	38.2	57.7	0.0	30.0
Credit to public enterprises 1/, 2/	...	...	9.0	19.2	9.7	-9.0
Credit to the private sector 1/, 2/	...	...	24.9	34.4	12.0	17.7
Yield on government bills (in percent)	45.7	28.7	34.2	42.0	28.9	28.1
	(In percent of GDP)					
Public finances						
Central government financial balance	-10.3	-8.1	-8.2	-7.9	-7.7	-5.0
Total outstanding public debt	76.3	74.6	73.7	116.7	116.1	95.6
Domestic revenue (excluding grants)	22.5	29.8	6.0	42.9	43.5	27.5
Total expenditure	29.0	28.6	26.2	27.7	32.7	26.1
Current expenditure	25.3	28.2	13.1	48.9	50.5	28.8
Capital expenditure and net lending	8.8	9.5	...	24.1	95.7	-38.7
	(In millions of U.S. dollars, unless otherwise specified)					
External sector						
Cedi per U.S. dollar (period average)	2,050	2,314	2,669	5,431	7,179	7,944
Real effective exchange rate (period average)	6.0	8.2	0.5	-35.5	0.7	-0.6
Nominal effective exchange rate (period average)	-15.0	-7.8	-9.3	-46.3	-24.0	-11.7
Current account	-7.0	-2.1	-4.4	-1.5	-0.7	0.1
Direct investment, net (in percent of GDP)	0.52	0.60	0.59	1.19	1.06	0.81
Portfolio investment, net (in percent of GDP)	0.3	-0.7	-0.4	0.1	0.6	0.0
Overall balance of payments	0.4	1.4	-1.0	-0.5	0.1	0.1
Change in external arrears	0	0	0	27	34	-61
Gross international reserves	480	550	317	264	344	635
In months of imports of goods and services	1.6	1.9	1.0	0.9	1.2	2.0

Sources: Ghanaian authorities; and staff estimates and projections.

1/ In percent of broad money at the beginning of the period.

2/ Credit from deposit money banks to public enterprises and the private sector, respectively.

9. **This environment could begin to change, however, if the government's economic reform program achieves its goals of eliminating net domestic borrowing requirements this year and in bringing inflation down to single digits by early-2004.** Although vulnerabilities remain due to Ghana's narrow economic base and the potentially large contingent liabilities associated with the weak financial condition of the social security fund, the positive fiscal developments so far in 2003 have led to a decline in the government's borrowing requirements, which in recent months has led to oversubscriptions of auctions and a sharp fall in nominal interest rates. The latter could fall further if confidence in the improved fiscal stance takes hold. This is likely to stimulate credit demand from the private sector, and lead the banks to take on more credit risk in their balance sheets. But, as will become evident in the rest of this section, there are a number of challenges for the financial sector (and its supervisors) to overcome if it is to meet this demand and successfully manage the associated risks.

B. Banking System Vulnerabilities

Exposure to Tema Oil Refinery

10. **One large systemically important bank is vulnerable due to its large exposure to TOR.** Although, a large portion of TOR's short-term debt was restructured into medium-term government bonds in 2001 and 2002, the company has begun to borrow again from one large bank due to government delays in implementing petroleum price increases. Indeed, that bank's on-balance sheet exposure to TOR has become excessive, exceeding 150 percent of its capital in August 2003. It also has large off-balance sheet exposures to TOR in the form of letters-of-credit. If the government implements the reforms to domestic pricing regimes intended to ensure full cost recovery in the energy, electricity, and water sectors, TOR should be in a better position to service its debts in the future.

High level of past-due loans

11. **Banks have begun to recover from the fallout of the adverse terms of trade shock and macroeconomic instability that were in progress at the time of the FSAP.** The sharp increase in inflation, rapid cedi depreciation, and the subsequent hikes in interest rates as the Bank of Ghana sought to slow money growth and bring inflation down in early-2001 took a toll on small and medium-sized borrowers. The negative effects on the banks' loan portfolios have been working their way through their balance sheets since then, as past-due loans (consisting of "other loans especially mentioned" (OLEMs) and NPLs) climbed from 16 percent of total loans at the time of the FSAP, to an eight-year high of 28 percent in 2001 and 2002 (Table 3). However, they began to decline in the first half of 2003, and were less than 26 percent in June 2003.

12. **The overall impact of the sharp increase in OLEMs and NPLs on the banking system was softened by most banks' high profits, owing to very wide interest spreads.** However, these margins have been narrowing since the FSAP as interest rates trend down in real terms. In turn, this could make it more difficult for the banks to carry large OLEM and NPL positions in the future.

Table 3. Ghana: Financial Soundness Indicators for the Banking Sector, 1997–2002
(In percent, year-end, unless otherwise indicated)

	1997	1998	1999	2000	2001	2002
Capital Adequacy						
Regulatory capital to risk-weighted assets 1/	15.2	11.1	11.5	11.6	14.7	13.4
Percentage of banks greater or equal to 10 percent	87.5	75.0	60.0	62.5	64.7	52.9
Percentage of banks below 10 and above 6 percent minimum	6.3	12.5	40.0	37.5	35.3	35.3
Percentage of banks below 6 percent minimum	6.3	12.5	0.0	0.0	0.0	11.8
Capital (net worth) to assets	12.9	12.8	11.6	10.7	11.9	11.4
Asset quality						
Exposure to the public sector / Total loans and securities	52.6	51.5	48.0	50.4	54.9	52.0
FX loans to total loans	25.6	28.5	33.4	35.3	34.1	33.8
Past-due loans to gross loans	24.6	18.9	20.1	16.2	28.0	28.6
Non-performing loans	21.6	17.2	12.8	11.9	19.6	22.7
OLEMs	3.0	1.7	7.3	4.3	8.4	5.9
Provisions as percent of past-due loans	78.0	89.4	67.2	58.6	46.4	63.6
FX provisions as percent of gross FX loans	0.9	2.4	3.5	4.7	5.4	6.4
Implied FX past-due loans to gross FX loans 2/	1.2	2.7	5.2	8.0	11.6	10.1
Cedis provisions as percent of gross cedis loans	25.5	22.6	18.4	12.1	16.9	24.2
Implied cedis past-due loans to gross cedis loans 2/	32.7	25.3	27.4	20.6	36.4	38.0
Past-due loans net of provisions to shareholder funds	14.2	6.5	22.5	24.7	49.6	30.7
Contingent liabilities to shareholder funds	71.3	163.3	144.0	38.3	97.5	105.3
Earnings and Profitability						
Return on assets 3/	n.a.	8.8	8.5	9.8	8.7	6.7
Return on equity 4/	n.a.	71.7	70.1	88.5	76.9	58.4
Net interest income/average assets	n.a.	11.8	10.2	11.4	13.4	10.0
Non-interest revenue/average assets	n.a.	5.9	6.8	10.0	5.8	6.7
Non-interest expenses/average assets	n.a.	7.4	7.3	7.6	7.5	7.8
Interest rate spread (deposit money banks)						
Lending rates minus demand deposits rates	37.0	33.8	32.5	30.5	30.5	30.5
Lending rates minus saving deposits rates	16.3	22.0	23.5	29.3	29.5	25.5
Lending rates minus time deposits rates (3 months)	7.8	9.0	14.8	13.8	20.7	20.5
Lending rates minus certificate of deposits rates	11.4	13.3	17.8	19.5	26.0	23.7
Liquidity						
Liquid assets/total assets 5/	57.8	57.8	53.4	48.4	42.7	50.8
Loan/deposit	42.2	48.7	59.0	64.0	63.9	50.1
FX liabilities/total liabilities	24.9	21.1	29.7	36.2	27.0	27.4
Sensitivity to market risk						
Net FX assets (liabilities) to shareholders' funds	62.9	48.1	(7.6)	(9.4)	22.9	24.3

Sources: Bank of Ghana, and IMF staff calculations.

1/ The method for calculating CAR is different from that of Basel CAR and is likely to be more conservative than the Basel method, since it applies higher risk-weights for some assets, such as interbank loans, and because fixed assets and certain investments are deduceted from both the numerator and the denominator of the ratio.
2/ The aggregate provisioning rate was applied to both FX and cedis loans. This assumes the same distribution of loans across classifications.
3/ Ratio of before-tax net income to average assets.
4/ Ratio of before-tax net income to average shareholder funds.
5/ Excludes government securities issued in exchange for TOR loans.

13. **Two small domestic commercial banks failed to meet the minimum capital adequacy requirement in 2002.** This has prompted bank supervisors to restrict their lending activities and to request that new capital be injected into these banks. However, their market shares and borrowings from other banks are small and unlikely to pose systemic risk.

Stress test results

14. **The stress tests performed for the FSAP were updated in order to illustrate the resiliency of the banking system.**[2] The results suggest that credit risk continues to be the main source of vulnerability for the banks. The methodology for the credit risk stress tests is discussed in Box 1, and the results are summarized in Table 4.

15. **The results suggest that some banks could be vulnerable if they were confronted by another shock similar to the one they have been coping with over the past two years**. However, this finding should be interpreted with caution. First, comparisons between these results and those from the FSAP are clouded by the fact that the original stress tests were run using data that predated the most recent macroeconomic and terms of trade shock—i.e., the initial level of OLEMs and NPLs used in the March 2000 stress test was only 16 percent, compared to 28 percent in December 2002. The banks are still recovering from that shock, and like a patient who is convalescing, would be vulnerable now if hit by a new one. Thus, it is not surprising to find that when one runs the stress tests now, a larger number of banks fall below the 6 percent minimum capital adequacy threshold, even though the banking system was strengthened by the closure of three weak banks in 2000 and the minimum capital requirement has since been increased to GC 70 billion for new banks.

16. **Moderate interest rate changes only have a limited impact on bank profits, since banks have been operating with modest gaps in shorter maturities and have some scope to adjust interest rates on liabilities if needed.** That said, as interest rates decline and deposit rates fall towards zero, it will become increasingly difficult for the banks to protect their current wide spreads.

17. **The banks' direct exposure to exchange rate risk is limited.** Exchange rate risk remains contained by most banks' holding short positions in cedis, and the Bank of Ghana's net open foreign exchange position regulations, which limit a bank's aggregate foreign currency open positions to 30 percent of its net own funds. This limit would imply a maximum loss (gain) of 3 percent of a bank's primary capital for every 10 percent of depreciation in cedis, depending on whether its aggregate open positions are long or short in cedis. At end-December 2002, five banks exceeded the limit by a range of 1.3–18.7 percentage points. However, all banks, except two small banks, showed net long positions on foreign currencies. Thus, they would be well-positioned to profit directly from any further cedi depreciation. That said, they could be adversely affected in an indirect sense if a cedi depreciation undermined the financial condition of their borrowers. Although this indirect effect was not assessed, it is implicitly captured to some extent by the credit risk stress test, which was designed to simulate the banks' experiences over the last several years when a large cedi depreciation put bank borrowers under stress.

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[2]The results are based on findings from the TA mission in May 2003.

Box 1. Credit Risk Stress Test Methodology

IMF staff updated the stress tests of the banks' resilience to credit risk using the same tests that were conducted for the FSAP. The same scenarios were applied because they continue to capture the most relevant aspects of the potential stresses facing the banking system as the macroeconomic and pricing reforms introduced by the authorities are not yet fully entrenched. Three scenarios were considered. In the first one, Staff assessed the extent to which solvency of the banks would be affected by future provisioning needs arising from recession-induced increases in non-performing loans. The second one assessed the effect on bank solvency of the need to redress under-provisioning for likely losses on existing impaired assets; while the third test assessed the impact of redeploying government securities into bank loans.

In Scenario 1, the downward migration patterns of loans from one classification to another were the same as those used in the FSAP. It was assumed that 20 percent of current loans would migrate to past due status at the beginning of the horizon, and would be classified as sub-standard after 90 days, as doubtful after 180 days, and as a loss after 360 days.[1] It was further assumed that once a loan turns past due, it stays nonperforming.[2] This translates into the following migration pattern for a given loan portfolio: (i) after 90 days, 20 percent of current loans migrate to OLEM, 100 percent of OLEM to sub-standard, 100 percent of sub-standard to doubtful, and 50 percent of doubtful to loss; and (ii) after 180 days (or an additional 90 days), 100 percent of OLEM to sub-standard, 100 percent of substandard to doubtful, and 100 percent of doubtful to loss.[3]

This migration pattern implied that total OLEMs and NPLs would increase by 15 percentage points to 43 percent of total loans 180 days after the initial shock—an increase that is only slightly larger than the 12 percentage points increase that took place between 2000 and 2002.

In Scenario 2, a provisioning rate of 50 percent against OLEMs and 100 percent against all NPLs was assumed. This is not unrealistic given historically low recovery values, the possibility of "evergreening" in overdrafts with no contractual terms of repayment, and the current practice among many banks of reactive (based on a schedule) rather than proactive provisioning and loan classification practices.

In Scenario 3, the staff assumed that each bank would reduce its investment portfolio by half and redeploy the funds into loans. Excluded from the test were government bonds issued to two banks in exchange for their TOR loans, since these bonds are not tradable. Considering that credit risk management skills are not likely to improve in the short run, the staff conservatively assumed that the new portfolio would have the same quality and be provisioned at the same rate as the existing loan portfolio. The overall impact of such a change in strategy would reduce the banking system's capital adequacy ratio to 11 percent, but the impact tends to be bigger for those smaller banks that currently have low capital positions.

1/ This is similar to the current Ghanaian loan reclassification requirement, except for the loss category for which the mission considered 360 days to be more realistic than 540 days used in Ghana.

2/ While this assumption may err on the severe side in that some large borrowers with access to foreign markets have at times bounced back, it does not materially affect the results.

3/ The staff also examined a revised version of Scenario 1 in which each bank's exposures to TOR and the Volta River Authority (the second largest borrower) were excluded from the scenario on the grounds that the financial health of these two entities should improve going forward due to recently introduced pricing reforms. However, the results were qualitatively the same as those in the original Scenario 1.

Table 4. Credit Risk Stress Test Results
(In percent, unless otherwise noted) 1/

		Scenario 1		Scenario 2	Scenario 3
	Initial Position	After 90 days	After 180 days		
FSAP Update (December 2002)					
Banking system capital adequacy	13.4	10.9	7.2	9.0	10.8
Number of banks below 6 percent	2	6	12	7	5
	(5.6) 2/	(29.0)	(63.8)	(31.4)	(28.0)
Number of banks below zero	1	4	6	5	2
	(5.6)	(7.1)	(10.4)	(8.1)	(5.8)
FSAP (March 2000)					
Banking system capital adequacy	11.0	8.2	6.2	7.5	7.9
Number of banks below 6 percent	0	4	7	4	4
	(0)	(37.0)	(44.9)	(27.6)	(37.0)
Number of banks below zero	0	0	1	1	0
	(0)	(0)	(4.8)	(4.8)	(0)

Source: IMF staff calculations.

1/ Scenario 1 assumes a 20 percent migration of current loans to past due in a 90 day period. Once a loan becomes overdue, it stays nonperforming, and will be classified as sub-standard after 90 days, doubtful after 180 days, and loss after 360 days. Scenario 2 assumes provisions are made at 50 percent against OLEM loans, and 100 percent against all nonperforming loans. Scenario 3 assumes 50 percent of each bank's securities portfolio is reinvested in loans that have the same quality and provisioning requirements as its current loan portfolio.

2/ Data in parentheses indicate these banks' share of total banking system capital.

Challenges posed by improving fiscal situation

18. **A large portion of bank lending continues to be absorbed by the public sector.** Exposures to the public sector—either in the form of loans to state-owned enterprises or holdings of government securities—continue to represent more than half of banks' loan and securities portfolios, reflecting Ghana's large fiscal deficits in the past and high secondary reserve requirements that require banks to hold at least 35 percent of their deposit liabilities in government securities, as well as structural impediments to lending to other sectors such as SMEs. The prevalence of high interest rates in real terms has served as a break on private sector credit growth and has also contributed to a sharp increase in bank holdings of cash and short-term funds.

19. **Continued success in implementing the government's economic program, however, could encourage banks to expand their lending to the private sector.** As noted previously, interest margins can be expected to shrink significantly; returns on assets would decline in response to the fall in interest rates associated with the reduced supply of treasury

bills, while deposits rates have less room to fall as they approach zero. This would likely force banks, especially rural banks which have large treasury bill holdings, to look for ways to alleviate the pressure on their net income. Naturally, they can be expected to try and boost their non-interest revenues, and look for ways to curb operating expenses, which are high by sub-Saharan African standards. They can also be expected to try and stretch for yield by redeploying assets from government securities to loans to service an expected increase in demand for private sector credit as fiscal crowding out wanes in importance.

20. **The potential increase in private sector lending will require banks and their supervisors to pay close attention to bank credit risk management practices to ensure that the added credit risk on bank balance sheets does not undermine the stability of the banking system.** Moreover, as illustrated in Scenario 3 of the stress tests, some smaller banks may need additional capital to backstop a shift from government securities to bank loans, unless they are able to manage the growth in their loan portfolios so that the increased capital requirements can be funded through growth in retained earnings.

21. **The banks' ability to adjust to a lower interest rate environment could also be constrained by high secondary reserve requirements.** In addition to the 9 percent primary reserve requirement, banks are required to hold at least 20 percent of their deposits in treasury bills and 15 percent in inflation-indexed government bonds. While the secondary reserve requirements have not posed much of a constraint until now given the high real yields available from treasury bills, they are beginning to bind for some of the larger banks that would like to engage in more lending to the private sector. In as much as the need for secondary reserve requirements should fall further with the continued decline in government borrowing requirements, the authorities were encouraged to consider replacing them with a more sophisticated framework for supervising bank liquidity management practices as the fiscal consolidation takes hold. This is especially true for the inflation-indexed bond requirement, since those securities are not a good match for banks' deposit liabilities given the former's longer maturities.

C. Pension System

22. **Further action needs to be taken to place SSNIT on a sound footing and address the weak governance arrangements that have plagued its performance in the past.** SSNIT is the second largest component of the financial sector with assets of GC 3.9 trillion, or 8 percent of total financial sector assets (Table 1, Appendix I). The appointment of a new Board of directors and a new director general in 2001 have helped to bolster the independence of SSNIT. However, its financial viability continues to be threatened by government interference in its funding arrangements and investment decisions—the most recent example being the government's proposal to redirect a portion of SSNIT contributions to a new health insurance program, which would further undermine SSNIT's already weak financial condition. As the largest single pool of long-term capital in the country, its weak financial performance has been a drag on economic growth and a threat to the future welfare of retirees.

23. **Over the medium term, the authorities could consider allowing contributors to divert a portion of their SSNIT contributions to private pension fund managers, and instituting a pension fund regulatory body.** In addition to providing SSNIT with some competition and future pensioners with more than one source of retirement income, such a policy would help to broaden the investor base in Ghana and provide more liquidity to domestic financial markets. However, it would be important to ensure from the outset that private pension schemes and their investment managers are well-regulated.

III. Financial Sector Development Issues

A. Banking Competition

24. **The banking system is dominated by the state-owned GCB and three foreign-owned commercial banks.** These banks account for about two-thirds of the system's assets and deposits. The importance of foreign-owned banks in the system has increased since the FSAP—to about 55 percent of system assets—due in large part to the migration of a domestic commercial bank to this category following its purchase by a French banking group.[3] Banks only reach about 5 percent of all households.

25. **Competition in the banking system appears to be weak.** Ghanaian banks have high overhead costs, and their pre-tax returns on assets and equity are among the highest in sub-Saharan Africa due to their very wide interest margins. However, these margins have narrowed since the FSAP as interest rates trended down in real terms.

26. **The government's planned divestiture of GCB has been suspended.** There is public concern about the potential foreign domination of Ghana's banking sector, and the attendant risk that the interests of ordinary Ghanaians could be overlooked, or otherwise adversely affected by the process of global integration. This concern is reflected in public opposition to the proposed divestiture of GCB, which led the government to suspend the sale of its remaining shares in that bank. That said, the decision to suspend the sale represents a lost opportunity to stimulate competition and foster a more efficient banking system.

27. **The authorities appear to have a view that the technical, managerial, and financial resources needed to make GCB competitive are likely to require the strategic involvement of an international bank, taking a majority shareholding in GCB.** They have not ruled out this option for the long run, and may be prepared to reopen the issue after the 2004 elections, and at that time it would be important for them to present a fuller and more convincing explanation to the public as to why foreign involvement in GCB would be

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[3]Foreign-owned *commercial* banks account for about 40 percent of banking system assets (Table 1, Appendix I), while foreign-owned *development* and *merchant* banks account for an additional 15 percent.

beneficial. In particular, the authorities could make clearer their intention to include in their divestiture plan safeguards on the maintenance of the branch network, since this was one of the main political concerns. In the meantime, the authorities are proposing an alternative plan to strengthen the governance of GCB that will entail raising new share capital and developing and putting out to competitive tender a management contract for the bank. These proposals are intended to be developed in more detail by the end of this year, and aimed to be announced in the 2004 budget statement.

B. Small- and Medium-Sized Enterprises' Access to Financing

28. **SME access to financing has been hampered by several important structural weaknesses, notably the lack of a conducive macroeconomic environment.** These borrowers face additional obstacles in accessing bank financing, such as their lack of access to adequate collateral and insufficient track records of creditworthiness. Key policies that need to be introduced urgently include: (i) ensuring timely payment of the government's obligations, in particular to SMEs so that they do not become overburdened by government arrears; (ii) improving corporate governance and financial reporting for Ghanaian firms, as well as introducing a suitable legal framework to facilitate the operation of credit reference bureaus; and (iii) addressing policy, legal, regulatory, and institutional bottlenecks for SMEs, such as inadequate property titles and weak judicial enforcement of foreclosure processes. Longer term measures include: (i) introducing more efficient payment instruments, such as common technological platforms for cash machines and point-of-sale facilities, and credit/debt cards to facilitate the emergence of e-commerce; and (ii) developing more effective ways to attract and facilitate investment from internationally-connected Ghanaians and other entrepreneurs with high potential for growth.

C. Housing Finance

29. **Most lenders have shied away from providing housing finance, leaving Home Finance Company (HFC) as practically the only financial institution supplying mortgages.** Discussions with stakeholders suggest that the reluctance of banks and other lenders to engage in housing finance reflects: (i) the poor macroeconomic policy environment, which has led many lenders to invest instead in high-yielding treasury bills; (ii) a weak property title system and inefficient foreclosure processes; (iii) weak institutional arrangements, with six ill-coordinated, yet interdependent agencies, and the effective absence of the dispute resolution bodies provided by the law; and (iv) poor management by the government of the land it owns or manages as a fiduciary agent of customary owners. The authorities were encouraged to extend the favorable legal framework that governs HFC's lending to other potential mortgage lenders, such as banks, to encourage more lending to this sector, and to reduce import duties on construction goods to lower the cost of building housing.

D. Insurance Industry

30. **The insurance industry remains underdeveloped, consisting mainly of short-term property and casualty business.** Insurance premiums as a percent of GDP were less than one percent in 2001, well below countries like Kenya, Tunisia, and Zimbabwe, and insurance company assets only represent about 1½ percent of the total for the financial sector. Less than 10 percent of insurance premiums are for life insurance policies, implying that the industry cannot be considered as a major source of long-term capital for the country. Several factors have contributed to the very low levels of insurance penetration, including: high inflation; low per capita income; lack of understanding of insurance among the population; and weaknesses in the policy framework for supervising insurance companies. The authorities were encouraged to proceed with the introduction of the planned insurance industry training center to improve business skills in the industry and build public awareness of insurance products.

31. **Many companies continue to experience financial difficulties.** Of the 18 companies operating in Ghana, 8 are insolvent, while 5 others are sufficiently weak that they have been asked by the National Insurance Commission (NIC) to prepare action plans outlining the steps they will take to recover. The market continues to be dominated by the State Insurance Company (SIC), even though it has ceded a significant share of the market to other companies over the last few years as many government agencies now use brokers to obtain their insurance. Two private companies have been particularly successful in increasing their market shares, and the market would benefit from giving companies like them more room to expand and develop their services; for example, by removing SIC's monopoly on the provision of insurance to the public sector. The state-owned reinsurer (Ghana-Re) still enjoys a protected market. Both SIC and Ghana-Re have reduced their staff over the last three years in order to cut costs and rebuild profits.

E. Financial Markets

32. **Financial markets remain at an early stage of development.**[4] Trading activity is limited on both the Ghana Stock Exchange (GSE) and in the government securities markets. Aside from privatizations, there has been little interest from companies to list their shares for trading on the exchange. The foreign exchange market is functioning better, and queues of unsatiated customer demand for foreign exchange have fallen sharply since 2000. However, an interbank foreign exchange market has yet to develop.

33. **Certain measures could help reverse this trend.** For example, improving local companies' financial reporting practices and governance procedures could help foster an investment culture and encourage more trading activity, as would rationalizing the tax

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[4]It draws on the findings of IMF report on Ghana's potential access to foreign capital flows.

treatment of investment income, which currently varies between capital market instruments and investment vehicles. More divestitures of shares of state-owned enterprises through the GSE, where appropriate, would increase the number of companies whose shares are listed on the exchange. Moreover, the impediments that the GSE faces as a small illiquid exchange could be partly overcome by having it pursue closer cooperation with the Nigerian Stock Exchange and the eight-member Bourse régionale de valeurs mobilières. Further liberalizing the ceilings on foreign portfolio investment (for residents of ECOWAS countries in the short term and for all foreign investors in the medium term) would also help provide more liquidity, by encouraging more foreign participation in domestic markets. However, Staff stressed that pursuance of this latter option is conditional on Ghana making further progress in improving macroeconomic fundamentals and in creating a strong and well-supervised financial sector.

34. **Trading systems and other market infrastructure are also in need of improvement.** Staff supported the authorities' desire to demutualize the GSE so that it can raise the capital it needs to invest in more efficient trading systems. Staff also indicated that while there is a need for a more efficient securities transfer system for the GSE and government securities markets, the cost of a proposed central depository with dematerialized securities should be thoroughly assessed and justified on a cost-benefit basis.

IV. Legal and Regulatory Framework

35. **A large number of new laws have been drafted to update financial sector legislation.** The FSAP highlighted a number of laws that needed to be implemented to bring the legal framework closer to international practices and strengthen the Bank of Ghana's supervision of the banking system. The authorities are to be commended for their efforts since then in introducing the new Bank of Ghana Act and the new Securities Industry Amendment Act, as well as drafting a large number of other laws, which should significantly improve the legal foundations for financial intermediation and the supervisory framework for prudential supervision. Those in draft stage include: (i) the Banking Bill; (ii) the Payments Systems Bill; (iii) the Bills and Checks Bill; (iv) the Money Laundering Bill; (v) the Offshore Banking Bill; (vi) the Foreign Exchange Bill; (vii) the Credit Union Bill; and (viii) the Insurance Bill.

36. **However, with the exception of new central bank and securities laws, the draft laws are still making their way through the legislative pipeline.** The Banking and the Payments Systems Bills are before parliament, and the Bills and Checks Bill is with the Justice Department, and will subsequently be sent to parliament. The Bank of Ghana has completed work on the Money Laundering Bill, which will be sent to the attorney general and subsequently to parliament. The authorities believe these four bills can be enacted this year. Meanwhile, they are in the process of completing the drafting of the other four bills and will attempt to introduce them in parliament in 2004.

A. Supervision of Banks and Non-Bank Financial Institutions

37. **Over the past three years, the Bank of Ghana has made good progress in modernizing its onsite and offsite supervisory procedures.** For example, it has: (i) successfully launched a capacity building program, which has resulted in the use of computer audit procedures for bank examinations; (ii) introduced a more streamlined Report of Examination covering the onsite inspection of banks; and (iii) and implemented stricter licensing procedures for new entrants in the financial system.

38. **Although three chronically weak banks have been closed since the FSAP, enforcement practices need to be tightened further.** As indicated in the Factual Update of Ghana's observance of the *Basel Core Principles* in the annex, there continues to be weak enforcement of prudential regulations. One example of the lack of proper enforcement of the laws and regulations is the absence of a strong supervisory action with respect to one small commercial bank that has been allowed to continue to operate with negative capital for more than two years, although its lending activities have been frozen. While various Memorandum of Understanding were concluded with it in 2002 and 2003, it has not injected the required additional capital. Similarly, many rural banks, finance companies, and savings and loan associations are allowed to operate despite having capital positions that are consistently below required minimums. Authorities indicated that the new Banking Bill will give them the needed legal foundation to tighten enforcement practices.

39. **Enacting the Banking Bill into law would also enable the Bank of Ghana to define new capital adequacy requirements, and issue new loan classification and provisioning requirements that are more in line with international practices.** The new law will also give it the ability to supervise banking groups on a consolidated basis. Once the new Banking Bill becomes law, the Bank of Ghana should issue guidelines on the conduct of consolidated supervision, and establish a system of cooperation and information sharing with other financial sector supervisors (such as the NIC), and with home country banking supervisors for the foreign-owned banks to facilitate appropriate consolidated supervision of these banks on a global basis.

40. **There is also a need to increase the Bank of Ghana's capacity to supervise bank exposure to various market risks.** This is becoming more important in light of the expected introduction of an interbank foreign exchange market in 2004. A review of the Examination Manual used by banking supervisors shows that while considerable emphasis is placed on documenting the objectives and the approach to onsite examinations, in planning onsite examinations, testing monitoring controls, and reviewing risk management practices, little guidance is offered in basic examination procedures in the foreign exchange area, back-office trading operations, and securities investments.

B. Insurance Supervision

41. **NIC has been trying to take action despite out-of-date insurance legislation.** The FSAP found that the regulatory framework for the insurance industry was weak, and that there were no on-site inspections of insurance companies. As indicated in the Factual Update of Ghana's observance of the *IAIS Core Principles* in the annex, this continues to be the case. Nevertheless, the NIC has introduced some significant changes to its operations, and has closed five insolvent companies. This has been done despite out-of-date insurance legislation, as it had been successful in adopting a liberal interpretation of its powers under existing legislation. The conduct of supervision still relies heavily on offsite analysis of financial information submitted by companies to monitor their financial condition. These data are gathered from annual returns, which are generally submitted after lengthy delays. There is still no program of regular onsite inspections even though many companies are experiencing financial difficulties. However, a taskforce was established in the middle of 2003 to conduct regular inspections of insurance companies, which will be backed by quarterly prudential reporting by insurance companies. The NIC is also in the process of establishing a program to monitor reinsurance companies.

C. Securities Regulation

42. **There have been some notable improvements to securities regulation.** As indicated in the Factual Update of Ghana's observance of the *IOSCO Objectives and Principles*, capital requirements for securities dealers have been improved, and dealers are now required to submit their cash flow statements to the SEC on a monthly basis (but only quarterly for balance sheet and income statements). In addition, the SEC has introduced a comprehensive set of regulations for collective investment schemes, such as mutual funds, and has taken over responsibility from the GSE for reviewing information memoranda and other materials related to securities offerings.

43. **Further steps could be taken, however, to bring securities regulation in line with best practices.** Although the new regulations for dealer capital requirements are a marked improvement over those in place at the time of the FSAP, they still fall short of best practice. In addition, the authorities were urged to reconsider their practice of allowing dealers to accept deposits, and to boost the penalties for securities regulation violations (which in some cases are the equivalent of only US$120 per day). They were also encouraged to consider extending the SEC's mandate to include the government securities market, since many entities regulated by the SEC are active in this market, and there are reports of continued instances of dealers transacting for their own accounts before satisfying their customer needs and other inappropriate trading behavior on the part of these dealers, which would be illegal if it involved equities or corporate bonds.

D. Public Debt Management

44. **The government's control over the structure of its debt was very limited until very recently when borrowing requirements started to wane.** The government's large borrowing requirements in domestic markets contributed to persistent undersubscription problems, and led to the acceptance of almost all bids at auctions. Investors continued to reveal a marked preference for 91-day treasury bills, leaving the government highly exposed to interest rate risk and rollover risk in its debt management activities. However, continued adherence to the fiscal program targets will help to alleviate these problems, and give debt managers more scope and options to begin exerting control over the structure of the debt stock and to lengthen its maturity. Indeed, the very recent decline in borrowing requirements has led to an oversubscription of recent auctions.

45. **The government's success in securing a sovereign credit rating for Ghana could boost investor awareness of Ghana.** In August 2003, Ghana received a B+ (stable) credit rating from Standard & Poor's. This should help investors differentiate Ghana from other countries in the region, and help signal the government's commitment to the pursuit of sound macroeconomic and structural policies. The ratings process may also help spur improvements to corporate governance and disclosure standards, which would strengthen the business operating environment and further enhance Ghana's access to foreign private capital.

E. Anti-Money Laundering/Combating the Financing of Terrorism

46. **The lack of AML/CFT legislation risks undermining Ghana's ability to address domestic financial system abuse as well as its reputation in the international community.** As the FSAP update mission was a limited update to the 2000–01 FSAP, no AML/CFT assessment was undertaken. On receipt of a request from the authorities, the IMF and the World Bank stand ready to provide technical assistance to strengthen the AML/CFT regime. Efforts are also underway for Ghana, as a member of the recently established FATF-style regional body for West Africa, to undergo an AML/CFT assessment, using the methodology endorsed by the FATF and the IMF's Executive Board in 2002.

F. Bank of Ghana

47. **There have been several important reforms to the monetary policy framework.** In January 2002, a new Central Bank Law came into effect. It establishes and guarantees the independence of the Bank of Ghana, confirms the pursuit of price stability as its primary objective, and includes provisions aimed at enhancing its operational efficiency and strengthening its supervisory role. It also paved the way for creation of a Monetary Policy Committee, which now meets every second month to set the stance for monetary policy. While the Bank's accounting and auditing practices have been significantly improved, the July 2003 IMF Safeguards Assessment noted that further steps should be taken to address remaining weaknesses in its financial controls. Moreover, the bank continues to hold shares

in a commercial bank—Ghana International Bank (London). Divesting these shares would help to bolster the independence of the central bank.

48. **The effectiveness of monetary policy instruments has also improved.** In March 2002, the bank established a "prime" central bank interest rate, which now serves as the rate charged to commercial banks for borrowing from the central bank on an overnight basis under the repo facility. Borrowings under this facility are collateralized by treasury bills. In late-2002, the reverse repo facility was restructured so that it is now a 7- or 14-day facility with rates set at the bank's prime rate less 1 percent. These steps should provide greater scope for interest rates beyond the very short term to be determined by market forces.

49. **There has not been any progress in recapitalizing the Bank of Ghana.** The FSAP recommended that the government recapitalize the bank in order to bolster its operational independence by replacing its large holdings of non-marketable claims on the government with negotiable securities that pay market rates of interest, and that consistent with the new Bank of Ghana Act, new shares be issued to increase the bank's capital from GC 100 billion to GC 500 billion. So far, no action has been taken, in part because the government has been preoccupied with the restructuring of TOR's obligations to the banking system and preferred to avoid another major recapitalization effort at this time. The need for a recapitalization is likely to become more acute now that the bank is absorbing the debt service cost for securities issued for liquidity management purposes.

V. Technical Assistance Support

50. **The IMF and the World Bank have provided technical assistance in several areas to help the authorities implement the FSAP recommendations**. The IMF has provided technical assistance on foreign exchange and domestic debt market and central bank accounting issues, while the World Bank has provided support in the areas of banking and NBFI regulation and supervision, insurance regulation and supervision, capital markets regulation and supervision, and to a lesser extent, social security reform. Going forward, the FIRST Initiative has agreed to provide technical assistance to support the authorities' efforts to launch the interbank foreign exchange market in 2004. The World Bank will provide ongoing technical support on government policy towards GCB (in conjunction with FIRST), and will also strengthen its support of social security reform. As noted previously, the IMF and the World Bank also stand ready to offer technical assistance to strengthen the country's AML/CFT regime.

FINANCIAL SECTOR OVERVIEW

51. **The financial sector includes a broad range of institutions, with the banking system accounting for most of the sector's assets** (Table 1). The bank assets-to-GDP ratio stood at 39 percent at end-2002. The aggregate balance sheets of the rural banks and other nonbank financial institutions have grown rapidly, but are very small, amounting to 5 percent of GDP in 2002. The insurance and pension sector is dominated by SSNIT, and is otherwise small.

52. **The level of financial intermediation in the economy is low by the standards of sub-Saharan Africa.** M2 as a share of GDP was a modest 19 percent in 2002, and the relatively high level of currency in circulation (8 percent of GDP) suggests that cash continues to be an important medium of exchange for economic transactions.

Table 1. Ghana: Financial System Structure, December 2002

	Number of		Financial Sector Assets		
	Institutions	Branches	(Billions of cedi)	(% of Sub-total)	(% of GDP)
Commercial banks					
Commercial banks	9	229	13,055	69.9	27.3
Large commercial banks	4	217	12,058	64.6	25.2
Ghana Commercial Banks (GCB)	1	134	4,624	24.8	9.7
Foreign-owned banks	3	83	7,434	39.8	15.6
Small commercial banks	5	12	997	5.3	2.1
Development banks	3	62	2,738	14.7	5.7
Merchant banks	5	18	2,875	15.4	6.0
Sub-total	17	309	18,668	100.0	39.1
Rural banks	115	353	864	100.0	1.8
Insurance companies (2001 data)					
Insurance companies	19	...	4,383	95.4	9.2
Social Security and National Insurance Trust	1	45	3,873	84.3	8.1
Other insurance companies	18	...	510	11.1	1.1
Reinsurance companies	2	...	213	4.6	0.4
Sub-total	21	...	4,596	100.0	9.6
Other nonbank financial institutions					
Building societies	2	8	11	0.7	0.0
Discount houses	3	...	442	28.9	0.9
Finance companies	13	...	191	12.5	0.4
Leasing companies	6	...	202	13.2	0.4
Mortgage finance	1	1	345	22.6	0.7
Savings and loans	9	10	143	9.3	0.3
Venture capital funds	2	...	46	3.0	0.1
Credit unions	250	...	152	9.9	0.3
Sub-total	286	....	1,531	100.0	3.2
Total financial sector	**439**		**25,659**		**53.7**

Sources: Bank of Ghana, and IMF staff calculations

Factual Updates of Selected ROSCs

A. Observance of Basel Core Principles for Effective Banking Supervision

Summary of FSAP conclusions

53. The 2000–01 FSAP assessed Ghana's compliance with the *Basel Core Principles for Effective Banking Supervision*. It found that Ghana exhibited a high degree of compliance with the principles, but noted significant shortcomings in several areas. The FSAP especially stressed the need for supervisors to act more aggressively in enforcing prudential standards as they had instead tended to favor moral suasion, which had proven to be either ineffective or at best, protracted.

54. Examples of some of the shortcomings included: (i) prior approval of the minister of finance was required to issue banking licenses and amend bank minimum capital adequacy ratios, and the Bank of Ghana was further required to consult the minister when dealing with banks in distress; (ii) Ghana had insufficient information sharing requirements because there were no arrangements in place between the various domestic agencies that are responsible for the soundness of the financial system, and weak supervision of foreign-owned entities because there were no formal memorandums of understanding with foreign supervisors in place; (iii) limits on foreign exchange exposures were not enforced; (iv) there was no anti-money laundering legislation in place; and (v) banking supervision was conducted on a solo basis with no regulations setting out rules for consolidation.

Factual update

55. The Bank of Ghana is still awaiting passage of the new Banking Bill. Passage of this legislation will strengthen the legal framework for bank supervision and licensing, and provide the Bank of Ghana with the authority and operational independence it needs to act more assertively in enforcing prudential regulations. It will also introduce consolidated supervision and information-sharing with other regulators. Similarly, passage of the pending Money Laundering Bill will help set the stage for further improvements in this area. In addition, the authorities have yet to conclude any memorandums of understanding for sharing information with supervisors of other financial sectors in Ghana or with foreign banking supervisors.

B. Observance of IAIS Core Principles of Insurance Supervision

Summary of FSAP conclusions

56. The 2000–01 FSAP assessed Ghana's observance of the *IAIS Core Principles of Insurance Supervision*. It found that Ghana exhibited only a weak degree of observance of the principles. However, the FSAP noted that the National Insurance Commission (NIC) has been able to exercise reasonably effective supervision, due to the quality and energy of its

officials and staff, and expressed optimism that a revised and strengthened legal framework would enable Ghana to achieve observance of more of the IAIS Core Principles.

57. Examples of some of the shortcomings included: (i) the lack of regular on-site inspections; (ii) the NIC's lack of formal authority to intervene when transfer of control is contemplated; (iii) the lack of rules on corporate governance; (iv) the lack of rules concerning matching of assets and liabilities and related party investments; (v) the absence of tests to confirm the adequacy of the reserve for unexpired risks and the any formal process for assessing the collectability of reinsurance recoveries claimed by the companies; (vi) the absence of a program to monitor reinsurance arrangements; (vii) lax reporting requirements; and (viii) while confidentiality was maintained in practice, there was no specific provision to do so in the law.

Factual update

58. The situation has not changed much since the FSAP. The lack of progress reflects existing staff and financial constraints, as well as inadequate insurance legislation. However, the new draft legislation contains provisions that address the corporate governance, internal controls, sanctions, and confidentiality requirements. It also addresses the need for regular reporting of insurance company financial information and regular onsite inspections. In the middle of 2003, the NIC established a taskforce to conduct regular inspections, which will be backed by quarterly reporting by insurance companies. It is also in the process of establishing a program to monitor reinsurance companies.

C. Observance of IOSCO Objectives and Principles of Securities Regulation

Summary of FSAP conclusions

59. The 2000–01 FSAP assessment was based on the September 1998 version of the *IOSCO Objectives and Principles of Securities Regulation*. It found that Ghana exhibited a high degree of observance of the principles. However, significant shortfalls were observed in several areas. These included: (i) the insufficient independence and internal controls for the regulator; (ii) the inability to cooperate and share information with foreign counterparts; (iii) the lack of risk-weighted capital requirements for licensees as well internal standards for intermediaries (notably in the area of cash transactions); and (iv) issuance of securities, and regulation of collective investment schemes.

Factual update

60. The Securities and Exchange Commission (SEC) has continued to update its regulations, and the SEC 2003 Regulations are now in place. The new Securities Industry Amendment Act (SIAA) was passed at the end of 2000, and the Unit Trusts and Mutual Funds Regulations were introduced in 2001.

61. With regard to the independence of the regulator, the oversight of SEC's activities by the minister of finance has been substantially reduced under the new SIAA. Nevertheless, the independence of the SEC continues to be undermined by its financial dependence on the ministry—the revenues raised from a new SEC levy on securities transactions will likely fall well short of meeting its financial requirements. The SEC now has an operations manual to guide and govern the actions of its staff, and provide adequate controls over their private investment activity. It continues to lack a written contingency plan to cope with market disruptions, although the Securities Industry Law gives it the power to cease trading in particular securities.

62. The SEC continues to have only limited bilateral arrangements for cooperating with foreign regulators, but intends to apply for participation in the multilateral Memorandum of Understanding that is being prepared by IOSCO. It may share certain types of information only in the context of a criminal investigation under Ghanaian laws. The purview of the SEC remains restricted to the field of "securities" that excludes Government of Ghana Treasury bills and bonds. Entities regulated by the SEC are active in the market for treasury bills, and there is anecdotal evidence of continued instances of front-running and other inappropriate trading behavior by these dealers. These actions, which would be illegal if related to equities or corporate bonds, remain outside regulation. It is recommended that the authority of the SEC be extended to all of the activities of its licensees.

63. The 2003 SEC regulations have amended the capital requirement to be a percentage of aggregate indebtedness, as determined by circular by the SEC, and the liquid funds requirement is linked to securities positions. The SEC also has the ability to require a broker to inject additional funds to enhance its liquidity. Moreover, the fine for not meeting capital requirements remains token and suspension of activities comes only after 30 days. The frequency of reporting has been improved from quarterly to monthly.

64. No amendment has been made to the provision in the Securities Industry Law that explicitly permits securities dealers to accept client deposits, in apparent contradiction of regulations which require deposit takers to be licensed by the Bank of Ghana. The 2003 SEC Regulations continue to explicitly determine the disclosure conditions for this practice. Moreover, there has not been any improvement in the regulations in place to prevent the use of broker-dealer accounts for money laundering purposes. There are no restrictions on transactions in cash, and no requirements to report activity which might be perceived to be of this nature.

65. Marked improvements have been achieved in the regulation of collective investment schemes. Under the 2001 Unit Trusts and Mutual Funds Regulations, closed-end investment vehicles are now possible, and comprehensive regulations have been introduced, which establish the basic tenets of collective investment schemes, including the separation of functions between investment managers, custodians and trustees.

66. In connection with principles relating to issuance of securities, the SEC has established review and approval powers for all public offerings through the SIAA.