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Ghana: Financial System Stability Assessment Update

This update to the Financial System Stability Assessment on Ghana was prepared by a staff team of the International Monetary Fund 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 May 2, 2011. 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 System Stability Assessment Update

Prepared by the Monetary and Capital Markets and African Departments

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May 2, 2011

This Financial System Stability Assessment (FSSA) Update is based on the work of a joint IMF-World Bank Financial Sector Assessment Program (FSAP) Update mission that visited Accra from July 21–August 5, 2010. Subsequently, a small team visited Accra to update developments through March 2011.

The team comprised of Messrs. Inutu Lukonga (Co-Mission Chief, IMF), Pierre Laurent Chatain (Co-Mission Chief, World Bank), Arto Kovanen, Kalin Tintchev (all IMF), Levent Deveci, Adrian Armas, and Moses Pelaelo (consultants to the IMF); Erik Feyen, Joaquim Gutierrez, Evans Osano, Antony Randle, Alice Zanza, Katia D'Hulster, Friedman Roy, Jose Garrido Garcia, and Yesha Yadav (all World Bank).

The mission's principal findings and recommendations are:

- Ghana's financial system has undergone rapid growth and major structural transformation over the last decade, which has brought new opportunities and risks. The authorities have been implementing reforms to strengthen the regulatory and supervisory framework and financial infrastructures.

- Nevertheless, the mission found that stability risks had heightened considerably, with high nonperforming loans (NPLs) and undercapitalized banks. The nonbanking sector also faced several constraints, including a scarcity of long-term finance, limited access to financial services, and high intermediation costs. The vulnerabilities in the banking sector largely reflect pervasive state involvement and deficiencies in risk management, supervision, and the insolvency regime.

- Against this backdrop, the mission recommended addressing stability risks while sustaining the momentum on broader reforms. It suggested giving priority to repaying government arrears, resolving problem banks, closing regulatory gaps, strengthening supervisory capacity and the insolvency regime, reducing state involvement in banks, and enhancing systemic risk analysis.

- More recent developments, based on a staff visit that took place in March 2011, suggest that immediate stability risks have been reduced, but underlying vulnerabilities remain. The authorities have made significant progress in implementing recommendations of the FSAP team, but a comprehensive and sustained reform effort will be needed to achieve long-term stability.

FSAP assessments 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.

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GLOSSARY

AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
BCPs	Basel Core Principles
BOG	Bank of Ghana
CAR	Capital Adequacy Ratio
CSD	Central Securities Depository
DvP	Delivery versus Payment
FATF	Financial Action Task Force
FIC	Financial Intelligence Centre
FINSSP	Financial Sector Strategic Plan
FSAP	Financial Sector Assessment Program
FINSSP	Financial Sector Strategic Plan
GDP	Gross Domestic Product
GIABA	*Groupe Intergouvernemental d'Action Contre le Blanchiment d'Argent en Afrique de l'Ouest*
GOG	Government of Ghana
GSE	Ghana Stock Exchange
ICAG	Institute of Chartered Accountants of Ghana
IFRS	International Financial Reporting Standards
IOPS	International Organization of Pension Supervisors
ISA	International Standards on Auditing
IT	Information Technology
LOLR	Lender-of-Last-Resort
MOU	Memorandum of Understanding
NBFI	Nonbank Financial Institutions
NIC	National Insurance Commission
NPLs	Nonperforming Loans
NPRA	National Pensions Regulatory Authority
NPS	National Payment System
OMOs	Open Market Operations
PDs	Primary Dealers
RCBs	Rural and Community Banks
RTGS	Real Time Gross Settlement
SEC	Securities and Exchange Commission
SMEs	Small and Medium Enterprises
SBs	State-Owned Banks
SOEs	State-Owned Enterprises
SSNIT	Social Security National Investment Trust
TA	Technical Assistance
T-bills	Treasury Bills

EXECUTIVE SUMMARY

1. **Since the 2003 FSAP Update, Ghana's financial system has undergone rapid growth and structural transformation.** Although the financial system remains relatively underdeveloped, the number of intermediaries and their scale of operations have increased, most notably in banking, insurance, capital markets, and micro finance. The range of financial services has also broadened and corporate structures are becoming complex, with conglomerates gaining importance. In addition, foreign shareholding, particularly from within Africa, has increased in the banking and insurance sectors.

2. **The authorities have been implementing reforms to enhance the financial system's resilience to shocks and its contribution to growth.** The recommendations of the 2003 FSAP Update were incorporated into the revised Financial Sector Strategic Plan (FINSSP) and a comprehensive reform package was developed. New regulations for banks, insurance, pensions, and anti-money laundering (AML) were enacted. The authorities also modernized the trading and settlement infrastructure for capital markets, the national payments system, and accounting standards. In addition, they improved the framework for systemic liquidity management, and established institutions to improve the enforcement of creditor rights.

3. **However, the FSAP team found that, despite these reforms, financial stability risks had heightened.** Although, in the aggregate, the banking system was liquid, profitable and highly capitalized, nonperforming loans (NPLs) were very high and a significant segment of the banking industry was fragile. Stress tests undertaken by the team indicated that even a moderate deterioration in asset quality of banks would have led to insolvency of several banks. In addition, gaps in the frameworks for bank resolution, systemic risk analysis, and crisis management rendered the Bank of Ghana (BOG) ill-equipped to deal with potential crises.

4. **The vulnerabilities reflect the interplay of several factors, but state involvement is an important element.** The state has controlling interests in five banks accounting for 29 percent of the banking system assets. The performance of these state-owned banks (SBs) has been poor, due to lending practices that focus on developmental objectives at the expense of prudential considerations. The losses of SBs have also created contingent liabilities for the government. Meanwhile, high fiscal deficits have compounded the NPL situation, as government arrears undermined the capacity of contractors to service their obligations to banks.

5. **The other contributory factors include deficiencies in commercial banks' risk management, supervision and the insolvency regime.** Commercial banks' internal controls and risk management practices have not kept pace with the industry's growth and changing risks. In addition, while government domestic arrears have been a recurring source of vulnerability, banks continued to rely on implicit government guarantees when lending to government service providers. Weaknesses in enforcing prudential regulations allowed banks to build up substantial loan concentrations while deficiencies in the analysis of individual bank risk and systemic risks have led to an under-appreciation of the stability risk implications. High credit risk is exacerbated by time consuming, legally complex, costly, and unpredictable procedures for taking collateral and enforcing creditor rights.

6. **The nonbanking sector does not pose systemic risk, but a number of constraints undermine its efficient functioning and contribution to economic development.** In particular, despite recent gains, long-term finance remains scarce, access to financial services is limited, and intermediation costs are high. The credit and collateral registries together with the commercial courts do not yet operate efficiently. Mechanisms are needed to enforce compliance with International Financial Reporting Standards (IFRS). The foreign exchange and domestic interbank markets are not sufficiently deep to support the efficient allocation of liquidity in the banking sector. Major efforts are also needed to bring the country into compliance with the Financial Action Task Force (FATF) standards. Moreover, the Social Security National Investment Trust's (SSNIT) sizeable portfolio in a very thin investment market introduces distortions in the financial system.

7. **Against this backdrop, the mission recommended expediting actions to minimize stability risks while maintaining the momentum on the broader reforms.** It urged the authorities to give priority to repaying government arrears that contributed to NPLs in banks, resolving the problem banks, addressing regulatory gaps, enhancing supervisory capacity and improving systemic risk analysis. It also underscored the need for a paradigm shift in the role the state plays in the financial sector. Preferably, the BOG should divest its shareholding in commercial banks, SBs should be managed on commercial basis, and developmental projects should be financed using institutions whose liability structures are appropriately funded and do not put depositors' funds at risk. These efforts need to be underpinned by further reforms of the insolvency regime, the regulatory and supervisory oversight of the financial system. The mission also emphasized that success of financial sector reforms would hinge on progress to rein in macroeconomic imbalances and on timely policy responses to bank problems.

8. **The policy actions recommended by the mission are summarized in Box 1 and more detailed recommendations are contained in Appendix I.** Additional recommendations are detailed in the Report on the Standards and Codes on Compliance (ROSC) with the Basel Core Principles (BCP) for Effective Banking Supervision attached as Appendix VI and several technical notes.

9. **The staff visit in March 2011 to update recent developments found that immediate stability risks have been attenuated, but underlying vulnerabilities remain.** The authorities have made significant progress in implementing the recommendations of the FSAP Update. The government has repaid the bulk of the arrears that contributed to NPLs in the banking sector, banks have been largely recapitalized, and management of SBs has been strengthened. Some progress has also been made to address the deficiencies identified in micro and macro-prudential regulation and supervision. The FINSSP was being updated to integrate the recommendations of the FSAP Update into a comprehensive reform program. Nonetheless, key sources of vulnerabilities remain and would require a longer time frame to address, most notably the state's involvement in the banking sector and the deficiencies in commercial bank risk management, supervision, systemic risk analysis, insolvency regime, accounting, and prudential data. Therefore, the recommendations of the FSAP remain valid and a sustained and comprehensive reform effort will be key to achieving long-term financial stability.

Box 1. Summary of Main Recommendations[1]

Safeguarding financial system stability

- Repay government related NPLs and resolve problem banks.
- Implement recommendations of the BCP assessment, giving priority to enhancing supervisory capacity and expertise, issuing guidelines, minimizing forbearance, and addressing regulatory gaps.
- Strengthen macro-prudential analysis of systemic risks.
- Develop a comprehensive framework for crisis management.
- Improve corporate governance particularly for SBs to ensure that banks are run on a commercial basis.
- Develop an exit strategy for BOG shareholding in banks.
- Improve the collection and analysis of data for offsite surveillance and risk analysis.

Systemic liquidity management

- Establish a plan for developing an interbank foreign exchange market.
- Develop comprehensive Lender-of-Last-Resort (LOLR) policies, guidelines, and procedures.

Promoting long-term finance

- ***Insurance sector***: Strengthen the regulatory framework, enhance supervisory capacity both in terms of staff resources and expertise and raise the minimum capital requirements.
- ***Pension sector***: Enact regulations, finalize guidelines, and develop an action plan to achieve compliance with International Organization of Pension Supervisors (IOPS) principles.
- ***Capital markets****:* Expedite the regulatory reforms, enhance supervisory capacity, raise minimum capital requirement for intermediaries, differentiate the capital according to business undertaking, and ensure operational and financial independence of the Securities and Exchange Commission (SEC).

Enhancing access to finance

- Raise minimum capital for rural and community banks (RCBs) and strengthen the prudential requirements and supervision.

Strengthening the financial infrastructures

- Further modernize the payment system by establishing interoperability to support retail payments, strengthening the BOG capacity to carry out the oversight function, enhancing oversight of the payment service providers and linking Real Time Gross Settlement (RTGS) system and the Central Securities Depository (CSD) to achieve delivery versus payment (DvP).
- Strengthen the framework for insolvency by enforcing compliance with the Credit Reporting Act and enhancing automation and coordination of all charge registries.
- Improve accounting and auditing by enacting a modern Accounting Act and establishing proper oversight of the profession.

Improving financial integrity

- Improve compliance with Anti-Money Laundering and Combating Financing of Terrorism (AML/CFT) by addressing the *Groupe Intergouvernemental d'Action Contre le Blanchiment d'Argent en Afrique de l'Ouest* (GIABA's) assessment report recommendations, pass the Economic and Organized Crime Bill, and provide adequate resources to the Finance Intelligence Center (FIC).

[1] For recommended timing, see Appendix I.

I. Background

A. Financial System Structure and Vulnerabilities

10. **Ghana's financial system is dominated by foreign-owned banks.** Commercial banks account for 75 percent of the total assets of the financial system, pension funds follow distantly with a 12 percent share, and the insurance sector is small with 4 percent (Table 1). Of the 26 commercial banks operating in Ghana, 13 are subsidiaries of foreign banks and their market share is estimated at 51 percent of bank assets. British banks dominate, but the combined share of banks from the Africa region is larger, particularly from Nigeria and Togo (Figure 1).[2] Given the dominance of foreign banks, cross-border contagion is an important risk.

11. **The domestic component of the banking system is dominated by SBs.** The state has a controlling interest in five commercial banks, through direct and indirect shareholding by the government, the BOG, and the state-controlled pension fund—the SSNIT.[3] The SBs account for 29 percent of banking system assets—one of the highest in the Sub-Saharan Africa region. Therefore, the interaction between sovereign and banking risks is high. In particular, the government has tended to use SBs to finance extra budgetary expenditures and the poor performance of SBs has created contingent liabilities for the government. High fiscal deficits have led to arrears that contributed to NPLs in banks. In addition, the conflict of interest created by the BOG's role as a shareholder and as a regulator has undermined supervision.

12. **Domestic financial conglomerates are increasing in importance even though they do not yet have a dominant presence.** The exact scope of conglomeration in Ghana's financial sector is not fully known. However, at least nine banks, which account for 53 percent of the banking system assets, have subsidiary securities firms and, in selected cases, industrial and insurance companies. Since the banks are not yet supervised on a consolidated basis, and there is no mapping of shareholders and common directors, it is possible that affiliate companies exist, thus, allowing related party lending to occur unnoticed.[4] These growing inter-linkages increase the potential for risks to have a system-wide impact.

13. **The financial sector has grown rapidly, although the growth has not had the intended effect of reducing intermediation costs.** Total financial system assets increased more than 13 fold over the last ten years to an equivalent of about US$16 billion (Table 1 and Figure 1). The growth has been underpinned by an increase in the number of players in the banking, insurance, capital markets, and microfinance sectors. However, while private sector credit increased,[5] a significant segment of the economy continues to have limited access to

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[2] The insurance sector exhibits similar trends. Of the 42 insurance companies operating in Ghana, 16 have significant foreign participation, eight are wholly foreign owned, and a number of new entrants come from Nigeria.

[3] The central bank has majority and significant shareholding in three commercial banks, while the SSNIT has majority shareholding in two banks and significant shareholding in 9 banks.

[4] The mission identified at least 12 banks that had common shareholders.

[5] By 2008 the annual growth in credit accelerated to 60 percent in nominal terms and 35 percent in real terms.

(continued)

finance. The competition also exerted more pressure on staff and funding costs while lending rates have remained high.

14. **Concentration has declined in the banking sector but it remains very high in the rest of the financial industry.** The market share of the five largest banks declined from 61 percent at end 2005 to 46 percent at end 2010, in part reflecting the licensing of several banks (Figure 1). In the insurance sector, the number of companies operating almost doubled. However, five out of 23 non-life insurance companies continue to write about 78 percent of the premiums and five out of 19 life insurance companies write 68 percent of the total life premiums. Similarly, in the capital markets, one company (AngloGold Ashanti) accounts for 67 percent of the stock market capitalization. The SSNIT, the main provider of pensions, accounts for over 80 percent of assets under management. Given the high degree of concentration, the stability of the industry could be impacted by developments in a small number of companies.

15. **There are also important risks inherent in the operations of banks and in the structure of their balance sheet and the profit and loss accounts.** Commercial banks are highly exposed to credit risk, since lending accounts for the bulk of assets and it has grown in an environment of weak credit risk management and enforcement of creditor rights.[6] Concentration risk is high with large exposures to single obligors and economic sectors (Figure 2). In addition, banks are increasingly lending to vertically integrated firms and to their employees. The cost structure of banks also exhibits rigidities that reduce banks' flexibility to respond to macroeconomic changes, resulting in high lending rates that respond slowly to changes in the policy rate.[7] The increased reliance on information technology (IT) for service delivery has increased exposure to operational risk.

16. **The government's dominance in economic activity, against the backdrop of weaknesses in fiscal management, further increases vulnerabilities in the banking sector**. State-owned enterprises (SOEs) and many small-and medium enterprises (SMEs) rely heavily on business from the government. Consequently, the government's accumulation of payment arrears to contractors and other service providers has undermined their capacity to service their bank loans and created NPLs across the industry. The team had estimated that 46 percent of the NPLs, reported at end-March 2010, were directly or indirectly linked to government arrears. The government subsequently paid off the bulk of the arrears identified at the time of the FSAP, but new arrears have since emerged, but their implications for NPLs in the banking sector is yet to be ascertained.

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[6] Credit risk in the form of nonpayment of premiums also threatens the insurance industry.

[7] The aggregate cost-to-income ratio is estimated at 72 percent for end-December 2010 and ranges between 50 percent and 128 percent. Banks face high funding costs because of: (i) the practice of benchmarking the corporate deposits rates to t-bill rates; (ii) a deposit structure that includes a large share of term deposits that lock in rates for periods of time, (iii) high overheads; and (iv) high NPLs and associated provisions that require banks to maintain high interest rate margins.

Table 1. Ghana: Structure of the Financial System, 2000–10

	Dec-00		Dec-05		Dec-09		Dec-10	
	Number	Percent of Total Assets	Number	Percent of Total Assets	Number	Percent of Total Assets	Number	Percent of Total Assets
Commercial Banks	16	76.9	20	70.5	26	75.1	26	75.1
Private	10	39.2	15	42.5	21	52.4	21	53.4
Domestic	5	4.0	6	8.0	8	12.7	8	15.1
Foreign	5	35.2	9	34.6	13	39.8	13	38.3
State-Owned 1/	6	37.7	5	28.0	5	22.6	5	21.7
Rural and Community Banks	113	2.0	121	4.3	134	3.3	135	2.7
Other Banking and Quasi Banking Institutions	33	3.9	34	4.7	46	5.0	47	4.6
Savings and Loan companies	8	0.2	12	1.0	18	1.6	19	1.8
Mortgage Finance Companies	1	1.4	0	0.0	1	0.3	1	0.3
Leasing and Finance Houses	21	1.2	20	2.3	27	3.0	27	2.5
Discount Houses	3	1.1	2	1.4	0	0.0	0	0.0
Nonbank Financial Institutions	57	17.2	80	20.6	113	16.6	134	17.5
Insurance companies	22	…	26	2.8	42	3.9	42	3.6
Life insurance	2	…	5	…	17	1.3	17	1.3
Non-life insurance	18	…	19	…	23	2.5	23	2.3
Reinsurance	2	0.0	2	…	2	0.0	2	0.0
Pension funds	…	12.5	…	17.8	…	12.7	…	12.4
SSNIT 2/	…	12.5	…		…	12.7	…	11.8
Other Public	…	…	…	…	…	0.0	…	…
Private	…	…	…	…	…	0.0	…	…
Securities Industry	35	…	54	…	71	0.0	92	1.5
Broker-dealers	14	…	18	…	22	…	21	0.3
Investment advisors	17	…	28	…	39	…	52	1.2
Custodians	-	…	3	…	4	…	12	…
Trustees	-	…	2	…	2	…	3	…
Total Financial System	254	100.0	291	100.0	364	100.0	387	100.0
Capital markets								
Equities*	22		30		36		34	
Bonds								
Collective Investment Schemes (CIS)								
Mutual Funds	0		5	…	9	…	14	
Unit Trusts	0		4	…	6	…	12	
Memorandum Items								
GDP (millions of cedis) 3/		2,715		9,726		36,867		44,465
Total financial sector assets/GDP 3/		56.7		53.7		50.7		52.1
Equity market capitalisation/GDP 3/		14.4		94.5		43.2		45.2
Equity market capitalisation (excluding AG)/GDP 4/				13.3		13.9		17.6
Debt market capitalisation/GDP 3/				12.1		8.5		8.0

Sources: Bank of Ghana, National Insurance Commission, Securities Commission, Ghana Stock Exchanges and SSNIT

Notes:

1/ This includes banks where the state has majority shareholding, directly or indirectly through equity holding by the government, BOG and SSNIT. It does not include Ghana International Bank in which the BOG also holds 51 percent shareholding.

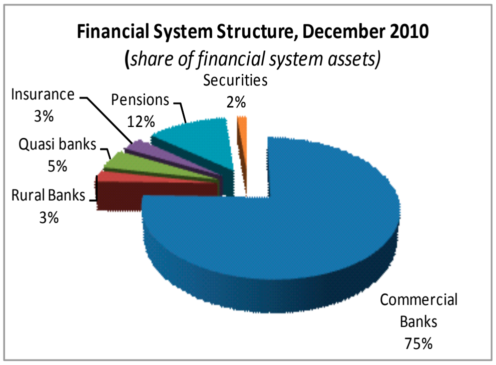
2/ Figures for 2000 were not available so they have been extrapolated from the 1999 figures.

3/ GDP has been substantially revised upwards and this has affected ratios from 2007 onwards that are scaled by GDP.

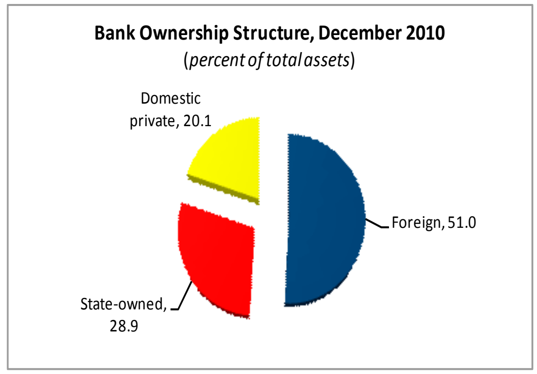
4/ AG denotes Ashanti Gold

Figure 1. Ghana: Banking System Structure and Trends, 2000–10

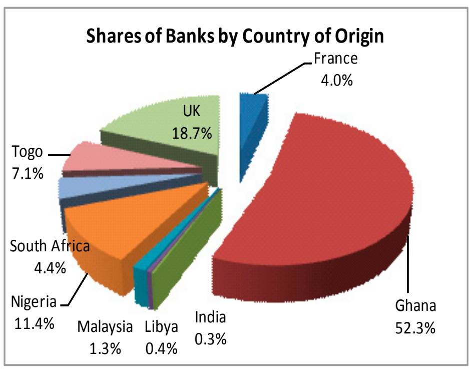
Ghana's financial system is bank dominated .....



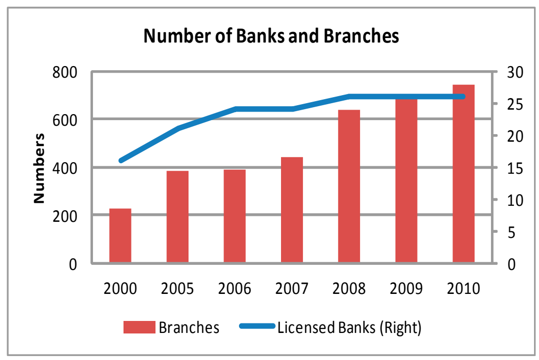
and most banks are foreign owned....



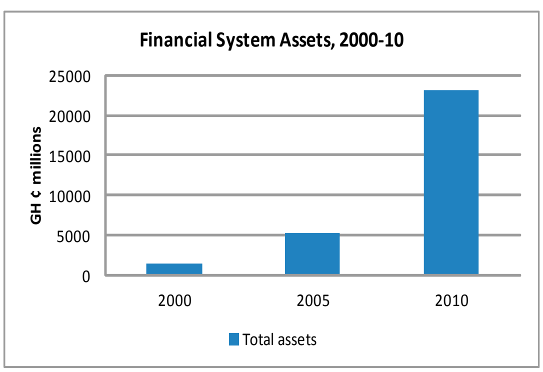
...and many of the foreign banks are from the Africa region.



The number of licensed banks increased significantly since 2007... and there has also been a phenomenal expansion of the branch network

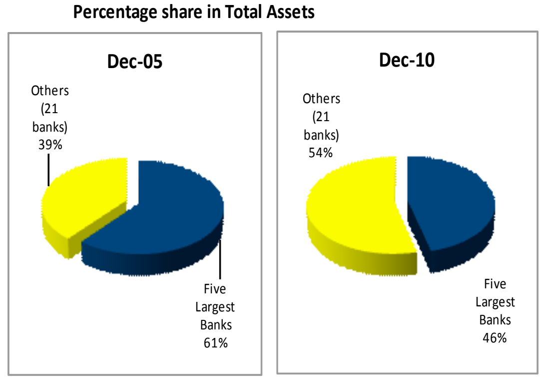


...but while the expansion led to an increase in the assets, the financial system's share in GDP has declined.



Nevertheless, the intensification of competition has helped to reduce concentration in the banking system.

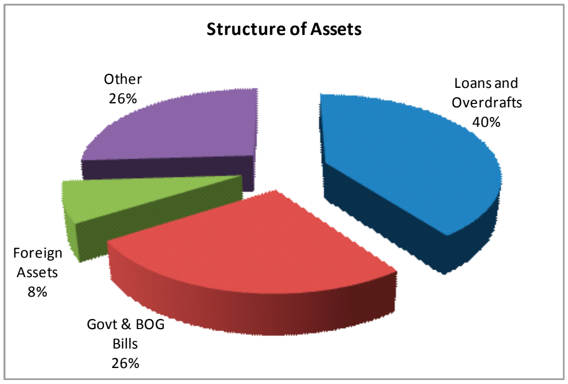
Percentage share in Total Assets



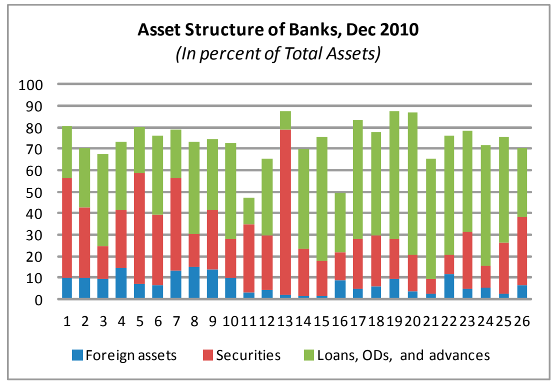
Sources: Bank of Ghana and IMF staff estimates.

Figure 2. Ghana: Bank Balance Sheet and Income Structure, 2010

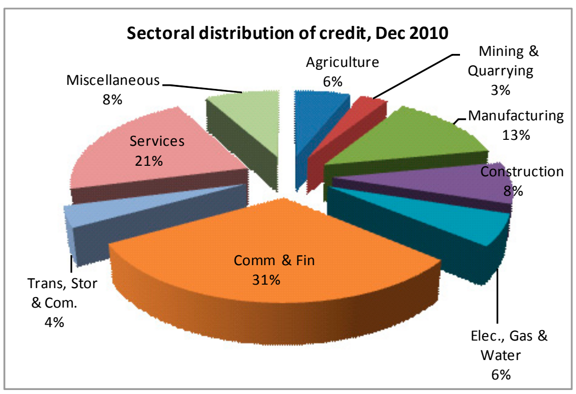
On aggregate, loans and overdrafts account for the bulk of bank assets…



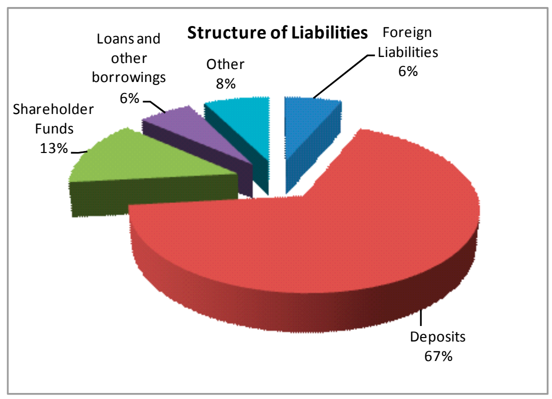
…but a number of banks have invested more in government securities.



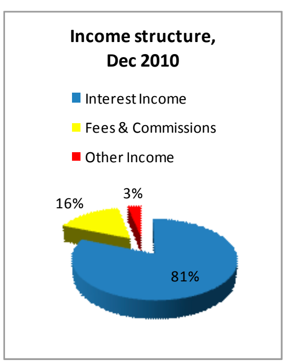
The lending is largely concentrated in commerce and finance and in services…

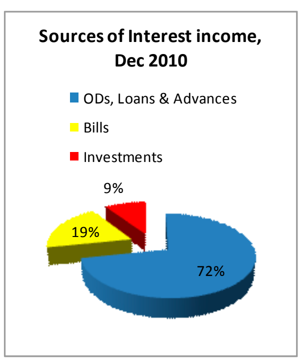


…and is predominantly funded by deposits, thus leverage levels are low

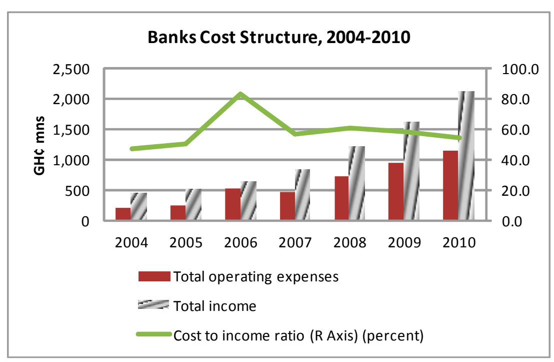


Reflecting the dominance of lending activities, interest income, particularly from lending remains the main source of income for banks…





…but banks' operating expenses remain elevated, though there are signs of the cost to income ratio declining and bank profitability improving.



Sources: Bank of Ghana and IMF staff estimates.

B. The Macroeconomic Environment and Risks

17. **Developments in Ghana's financial sector have been underpinned by mixed macroeconomic performance (see Figure 3).** Prior to the crisis, Ghana registered sustained high GDP growth, a stable exchange rate, and a favorable balance of payments position, while the BOG abolished secondary reserve requirements—all of which created favorable lending conditions. However, in the run up to the 2008 elections, the macroeconomic environment deteriorated rapidly, reflecting a confluence of a food and energy crisis and an expansionary fiscal policy. As fiscal deficits widened, inflation accelerated, interest rates rose to around 30 percent, investors became skittish and began to exit the debt market, and the exchange rate began to depreciate, thereby creating conditions for asset price deterioration.

18. **The global financial crisis compounded incipient pressures in the domestic economy resulting in a massive deterioration in the quality of banks' assets.** In the aftermath of the crisis, Ghana's GDP growth decelerated significantly; inflows from portfolio capital and remittances declined; and the depreciation in the exchange rate accelerated.[8] Concurrently, the government was unable to make payments to contractors and other service providers, and this in turn, created NPLs across the banking system. The deceleration in growth also occurred mainly in the non-cocoa/gold sectors which constitute the bulk of the banks' loan portfolios.[9] This added to NPLs and also exposed weaknesses in loan underwriting standards.

19. **More recently, the macroeconomic environment has improved which should be favorable for the banking sector.** GDP growth is estimated at 6.6 percent in 2010 and projected to increase further to 14 percent in 2011. The start of oil production in 2010 has reinforced the fiscal and external outlook. The financial sector could benefit from the downstream activities from the oil sector. Liquidity in the banking system has increased substantially and the pace of lending to the private sector has recovered in the first half of 2010.

20. **However, a number of downside risks stemming from the macroeconomic environment persist.** The potential for expenditure overruns is high ahead of elections in 2012, and fiscal slippages that lead to an accumulation of new arrears could negatively impact the banking sector. High banking system liquidity— resulting from a combination of increased capital inflows, high commodity prices and fiscal imbalances—could encourage greater risk taking by banks, in light of the recent increase in minimum capital requirements. Tail risks such as a shock to cocoa prices, could have wide repercussions for fiscal revenues, NPLs, and the exchange rate that could feed back to the banking sector through increased credit risk. These risks are further elaborated in the Risk Assessment Matrix attached as Appendix III.

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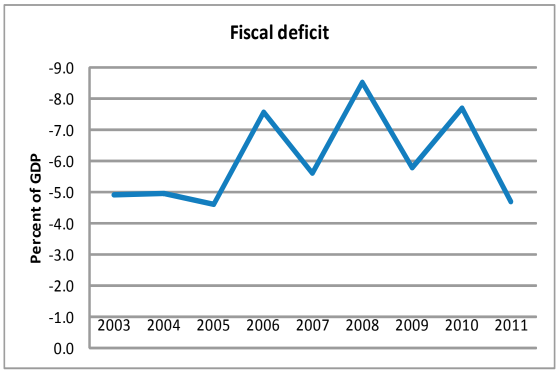
[8] Foreign investors had increased their participation in government debt markets. In 2008, following the global crisis, a number of these investors exited their positions. This contributed to exchange rate depreciation by more than 50 percent between May 23, 2008 and the peak of July 30, 2009 and to increased funding costs in the short-term money markets.

[9] The two dynamic sectors (cocoa and gold) that have driven growth source their funds in international markets.

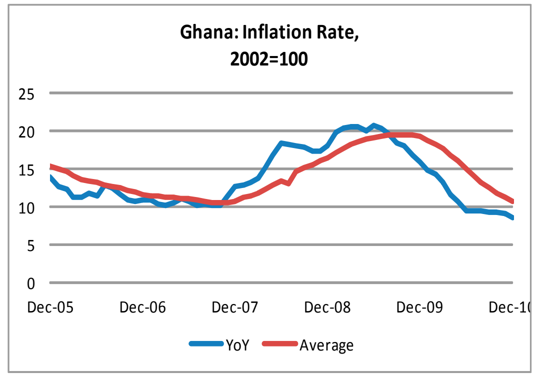
Figure 3. Ghana: Selected Economic Indicators, 2004–10

Developments in the banking sector has been underpinned by mixed macroeconomic performance

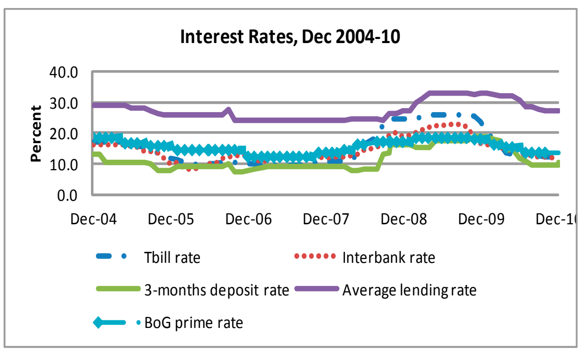
Fiscal deficits widened in the run up to the last elections of 2008 ….



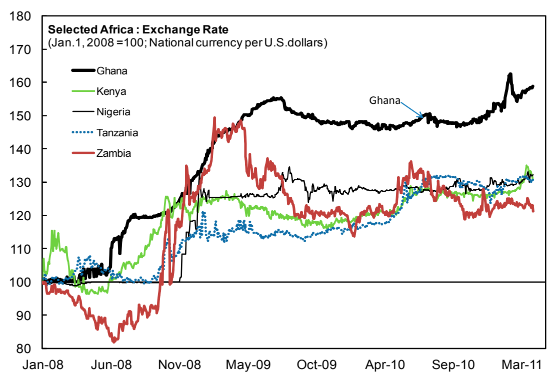
Inflation accelerated before moderating in the last year…



Interest rates rose sharply and despite recent declines in the policy rate lending rates have only declined marginally…

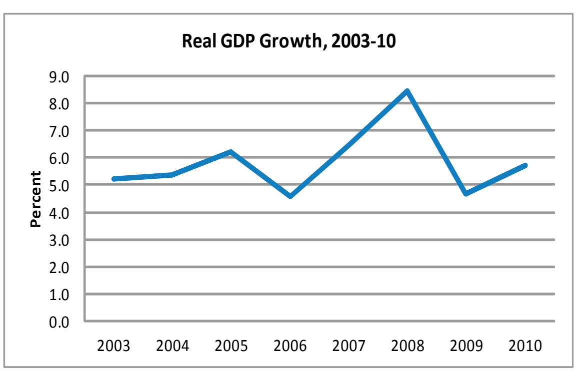


The exchange rate depreciated significantly before stabilizing at the depreciated level …

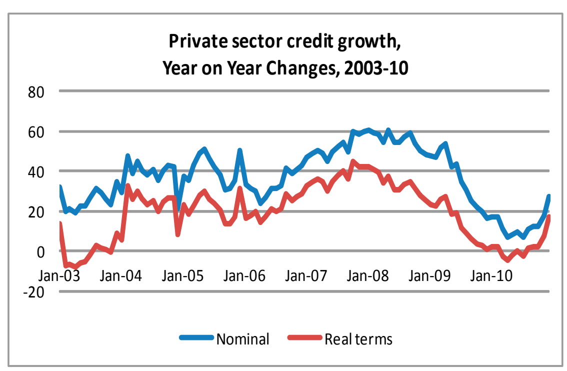


Source: Bloomberg LP.

As the financial crisis compounded domestic pressures, GDP growth slowed temporarily but prospects are favorable given the start of oil production…



Credit growth which had slowed in the face of high NPLs has also rebound briskly in the second half of 2010.



Sources: Bank of Ghana and IMF staff estimates.

II. Overall Banking System Stability

A. Banking System Soundness and Resilience

Current condition

21. **Official financial soundness indicators do not provide an adequate picture of the soundness of the banking system due to weaknesses in banks' financial accounts** In particular, the mission noted a variety of practices that result in an overstatement of capital, profitability, and liquidity in the banking sector. These include: (i) the misclassification of NPLs particularly those linked to government arrears; (ii) under-provisioning for NPLs; (iii) the treatment of restructured loans as current; (iv) accrual of interest on NPLs; and (v) the reporting of encumbered treasury securities among liquid assets.

22. **Nevertheless, notwithstanding data weaknesses, capital in the banking system has on aggregate increased and liquidity remains high (Table 2).** The high capital levels mainly reflect the recent increase in minimum capital requirements and the significant and increasing share of zero risk-weighted treasury securities.[10] The substantial liquidity in the banking system reflects a combination of intensified deposit mobilization efforts by banks, elevated government expenditures and increased foreign inflows, most notably foreign direct investment, remittances, and portfolio capital flows. Banks have also remained largely profitable.

23. **However, NPLs are very high across the industry and pockets of fragility remain.** At end December 2010, NPLs were estimated at 17.6 percent and several banks, including systemically important domestic banks and subsidiaries of reputable international banks, reported higher NPL ratios in the range of 20–40 percent. Though improving, misclassification and under-provisioning for loans is still a common occurrence among banks. Adjustments to the figures made by the team for some of the obvious misclassifications and lending to shareholders, suggest that some of the small and medium sized banks may be undercapitalized. The restructuring of a couple of banks previously identified weak banks is yet to be completed.

24. **The performance of the banking sector and its ownership structure compares unfavorably with peer countries (Figure 4).** Aggregate capital adequacy levels and bank profitability are in line with other countries, but the NPL ratio is much higher than most peer countries. As for the ownership structure, the share of foreign banks is comparable to most other countries but state ownership of banks is among the highest in the region as is the ownership of commercial banks by the central bank.

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[10] In 2007, the minimum capital requirement was increased from ₵7 million to ₵60 million. Foreign banks had to meet the new requirements by end-December 2009. Local banks were required to meet the new requirement by end-2012 but in the interim to increase their minimum capital to ₵25 million by end-December 2010.

Table 2. Ghana: Financial Soundness Indicators, 2003–10

(In percent)

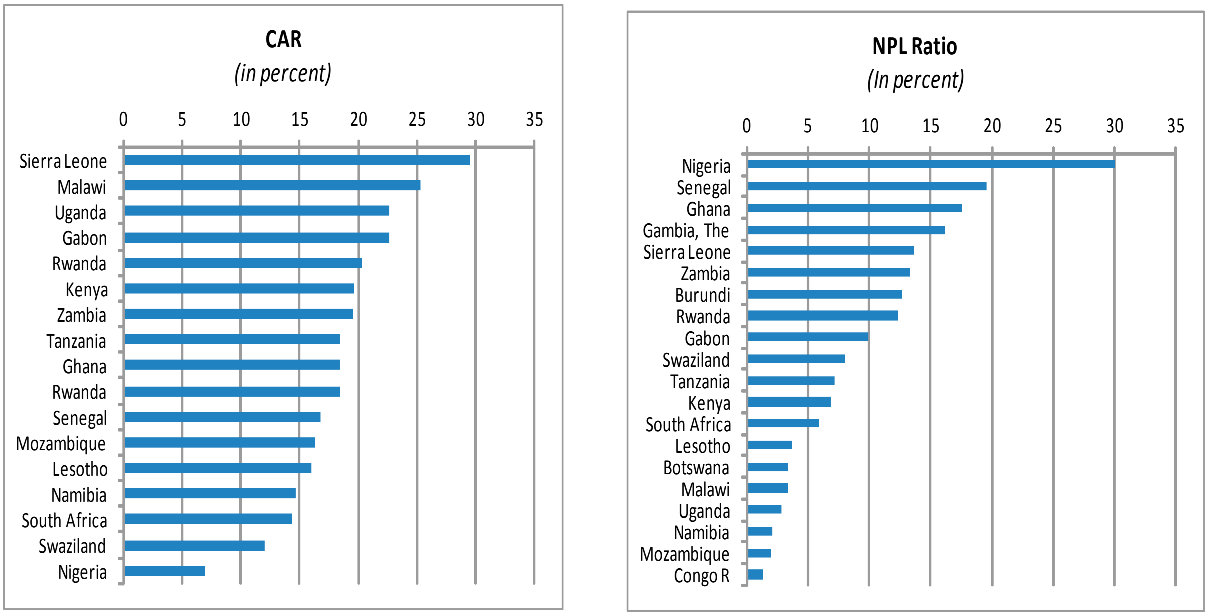
	2003	2004	2005	2006	2007	2008	2009	2010
Capital Adequacy								
Capital to risk weighted assets	9.3	13.9	16.2	15.8	15.7	13.8	18.2	19.1
Tier I capital to risk-weighted assets	…	…	16.2	15.0	13.6	12.8	17.0	18.6
Asset Quality								
Nonperforming loans to total gross loans	18.3	16.1	13.0	7.9	6.4	7.7	16.2	17.6
Loan-loss provisions to nonperforming loans	61.9	57.5	65.6	73.3	68.5	66.7	58.2	53.2
NPL net of provisioning to capital	…	…	…	1.9	4.8	7.7	19.9	29.2
Profitability and Efficiency								
Return on assets 1/	4.3	4.5	3.0	3.3	2.6	2.5	2.1	2.7
Return on equity	53.1	50.6	39.8	39.6	35.8	30.1	23.6	28.6
Net interest income to gross income	49.3	50.7	51.6	51.8	46.1	41.3	39.4	50.1
Noninterest expenses to gross income	47.5	48.2	54.3	52.7	52.9	54.2	51.4	51.8
Liquidity								
Liquid asset to total assets 2/	29.5	27.0	20.7	23.5	23.3	25.2	26.3	25.3
Liquid asset to short-term liabilities	40.9	38.1	28.1	31.8	31.3	33.5	34.5	32.9
Exposure to foreign exchange risk								
Share of foreign currency deposits to total deposits	30.8	29.3	26.3	28.1	22.3	28.4	32.7	
Net open position in foreign exchange to capital	…	…	…	…	…	…	…	
Memorandung Items								
Adjusted CAR 3/								18.8
Adjusted NPL ratio 4/								18.6

Source: Bank of Ghana.

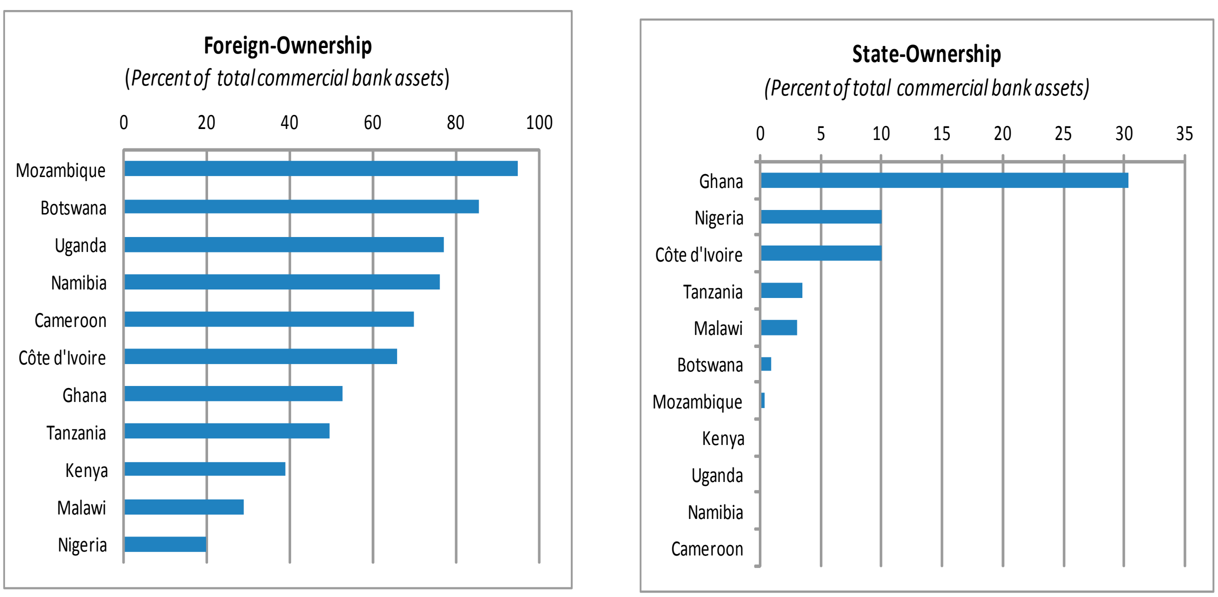
1/ This figure to some degree overstates bank profitability in so far as it includes interest accrued on loans that have not been performing for years.
2/ This figure includes assets that are encumbered and therefore overstates the liquidity position to that degree.
3/ The CAR was adjusted for lending to shareholders and to take account of the loans that were previously inappropriately classified as current.
4/ The NPL ratio reflects the re-classification of exposures to OSNOR plant, Nyame Iye Cold Storage, the AU Development Consortium, and the exposure to the National Youth Employment Program (NYEP).

Figure 4. Ghana: Comparative Structural and Financial Indicators

While the level of bank capitalization is comparable to other countries in the region, the extent of asset deterioration is worse...



The degree of foreign shareholding is also comparable to other SSA countries but state ownership is among the highest...



Sources: IMF staff estimates and various country authorities.

Contributory factors

25. **The vulnerabilities in the banking sector are attributable to the interaction of several factors, but government involvement in banks' operations is an important element.** SBs account for a large share of banking system assets and this group of banks has underperformed due to conflicting development and commercial banking objectives that have led to weaknesses in lending practices. In addition, government domestic arrears have been a recurring source of banking system vulnerability as they undermine capacity of providers of services to the government to repay their bank loans in a timely manner.[11] Furthermore, since term deposits are benchmarked to treasury-bill (t-bill) rates, high fiscal deficits affect banks' funding costs, contribute to high lending rates, and erode capacity to service debts.

26. **Weaknesses in commercial banks' risk management and in supervision have also been important factors.** Commercial banks' internal controls are generally lax and risk management practices have not kept pace with the growth of the industry and the changing risks. Though government domestic arrears have been a recurring theme, banks continue to rely on implicit government guarantees and do not take additional security. In addition, the intensification of competition and increased liquidity has engendered higher risk taking and inadequate attention to required controls. Regulatory forbearance also enabled banks to build loan concentrations above regulatory limits and to maintain inadequate provisions. Deficiencies in prudential data collection and analysis have prevented identification of systemic risks.

27. **Banks in Ghana have high operating costs and rigidities in their cost structure that reduce their flexibility to respond to a changing macro-environment.** Overhead costs are high and comprise mainly of staff related expenses (50–55 percent) and growing administrative costs (25–30 percent).[12] The high administrative costs are partly attributable to the rapid expansion of banks' branch networks as the banks competed to gain market share and to tap lower cost deposits. By the same token, demand for qualified personnel outstripped supply thereby pushing staff costs up. The need for large branch networks reduces scope for significantly reducing administrative costs in the immediate term.

28. **The deficiencies are exacerbated by the weak environment for enforcing creditor rights.** Despite the establishment of commercial courts and the collateral registry, banks reported experiencing prolonged delays in foreclosing on collateral. In particular, the complex

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[11] The mission estimated that 46 percent of the NPLs at end March 2010 were directly or indirectly caused by the government's accumulation of domestic arrears and were heavily concentrated in SBs. Government related NPLs consisted of: (i) NPLs by energy related SOEs that had not received subsidies for the under-recoveries on petroleum products at the directive of the government; and (ii) impaired assets due to the government's nonpayment of vendors and contractors.

[12] Staff computations indicate that the higher locked-in funding costs and a consistently large (12–13 percent) interest margin are major contributors of the high lending rates. The margin is mainly driven by high overhead costs (7.6 percentage points), which are mainly comprised of staff-related expenses (50–55 percent of overheads) and growing administrative costs (25–30 percent of overheads). An important reason for high overhead costs is a lack of scale economies due to the small system and average bank size. Profit margins on the other hand were small (0.0–0.5 percentage points).

and time consuming procedures for taking possession of collateral pledged as security for loans result in low debt recovery rates.

Resilience of banks to shocks—Stress test results

29. **The mission used stress testing to assess the resilience of the banking system to shocks based on bank-by- bank data for end-December 2010**. The stress test results are summarized in Table 3 below and the methodology and assumptions are outlined in Appendix IV.[13] The results should be interpreted as baseline, since feedback loops and other interactions that have potential to magnify the shocks, are not adequately reflected in the analysis due to data limitations and the absence of a macro consistent model.

30. **The results of updated stress tests indicate that stability risks in Ghana's banking system have been substantially reduced, but underlying vulnerabilities remain.** At the end of December 2010, all but one bank complied with the capital adequacy requirement of 10 percent and only two small banks fell short of meeting the minimum capital requirements. Three banks became undercapitalized when the accounts were adjusted for under provisioning and insider lending, but the degree of undercapitalization is modest and the share of assets for the undercapitalized banks is small. These results indicate a significant improvement compared to the stress-tests performed by the mission in August 2010, reflecting the repayment of government related NPLs, an intensification of debt recovery efforts by banks, and an increase in capital as part of banks' efforts to comply with the new minimum capital requirements. The improvements, however, seem tenuous as the tests show that modest increases in lending that shifts assets from low to higher risk weighted assets (RWA) could result in several banks failing to comply with capital requirements.

31. **Credit risk and concentrations in loan portfolios continue to present a major risk to banking system stability.** At least 10 banks with an asset share of 41 percent continue to have concentrations where the default of a single obligor would result in them breaching the CAR and two of them, with a market share of 16 percent, would become insolvent. Similarly, eight banks with a market share of 27 percent would breach the capital adequacy requirements, if loans that are currently classified as substandard and doubtful migrate across the transition matrix, and 11 percent of current loans become nonperforming.

32. **Liquidity risk is less of a systemic threat but there are some pockets of vulnerability.** Updated stress tests indicate that two banks remain highly vulnerable to liquidity risk. These two banks depend heavily on public sector deposits to finance their asset growth, and if the central government and public institutions were to withdraw their deposits from commercial banks, they could see their liquid asset ratio falling below 10 percent. More generally, small banks are more exposed to liquidity risk than big banks. This is because big banks have a network of branches through which they are able to tap low-cost deposits, while

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[13] Detailed stress tests were performed by the FSAP team in August. The methodology and assumptions together with the results of that exercise are detailed in a technical note.

smaller banks rely heavily on public sector and other wholesale deposits. Some of the smaller banks also use their t-bills as security for corporate deposits and the encumbered assets would not be available to meet deposit withdrawals.

33. **Cross-border contagion is considered by the industry to be an important risk, but the mission was unable to quantify its potential impact.** Data on the banks' intra-group exposures was not available. In addition, the recent turbulence in Nigerian banks could not provide a historical perspective on the potential cross-border contagion, since the parents of banks currently in Ghana were not directly affected. Tests undertaken by the mission indicated that one bank had significant direct exposures to the parent bank. However, discussions with the banks suggested that the collapse of a parent bank could easily undermine confidence in the subsidiary and trigger a deposit run on banks considered to be of the same asset class.

34. **Market risk is not significant but indirect credit risk has not been quantified.** Stress tests performed by the team showed that direct balance sheet effects of an exchange rate change were minimal, and latest data show that banks have continued to maintain low open positions. Similarly, banks exhibit resilience to changes in interest rates, in large part because most lending is at variable rates. However, exchange and interest rate changes can erode the incomes and debt service capacity of borrowers, thus, the balance sheet of banks would be indirectly affected through increased credit risk.

35. **Macroeconomic risks pose a greater threat because of the potential simultaneous impact on asset quality, the exchange rate, interest rates, and liquidity.** The two possible scenarios of a fiscal deterioration and a shock to cocoa prices, yield results that were similar in magnitude. Both have direct implications for interest rates, exchange rates and NPLs, but the greatest threat comes from a fiscal deterioration given the higher probability of occurrence.

Table 3. Ghana: Selected Stress Test Results 1/

(In percent, unless indicated otherwise)

	Regulatory Capital to Risk-Weighted Assets (CAR)											
	Weighted average for banking system	Large banks	Medium banks	Small banks	Domestic private	Foreign-owned	State-owned	Number of banks below statutory CAR	Asset share of banks below statutory CAR	Number of banks with negative CAR	Asset share of banks with negative CAR	Number of banks below minimum capital
End-December 2010 CARs as reported by the Bank of Ghana (BOG)	19.1	18.7	17.7	19.7	13.6	25.3	14.0	1	2.5	0	0.0	2
Adjusted CARs 2/	18.9	18.7	17.3	19.3	12.6	25.0	13.8	3	7.6	0	0.0	4
Single Factor Shocks												
Credit risk (migration of existing NPLs) 3/	17.7	17.6	16.5	18.1	11.3	24.3	12.5	5	13.8	0	0.0	4
Credit risk (migration of existing NPLs and 50 percent increase in NPLs) 4/	16.1	16.3	15.2	16.8	9.4	10.5	11.2	8	27.2	0	0.0	5
Credit concentration risk (failure of the largest borrower)	9.1	-5.5	9.8	14.5	9.8	19.5	-8.0	10	41.5	2	16.5	6
Direct exchange rate risk (50 percent appreciation)	…	…	…	…	…	…	…	…	…	…	…	…
Direct exchange rate risk (50 percent depreciation)	…	…	…	…	…	…	…	…	…	…	…	…
Direct interest rate risk (1000 b.p. interest rate increase)	22.9	22.9	21.1	23.4	16.0	16.4	16.6	1	2.2	0	0.0	2
Direct interest rate risk (300 b.p. interest rate decrease)	18.3	18.3	16.7	18.7	12.0	24.5	13.5	4	12.2	0	0.0	4
Migration of assets from low- to high risk weights (25% increase in RWA)	14.8	14.8	13.3	15.3	9.8	20.1	10.7	9	29.9	0	0.0	4
Scenario Analysis												
Fiscal scenario	14.1	14.2	12.7	14.5	6.5	21.5	8.5	11	44.0	2	3.9	8
Cocoa price shock 5/	15.5	15.6	13.9	16.3	9.3	22.4	10.3	10	32.0	0	0.0	4
Liquidity Stess Tests												
Liquid asset to total deposits (end Dec 2010) 6/	49.5	54.7	42.3	48.4	47.3	50.5	49.4					
15 percent withdrawal of SSNIT deposits and 100 percent withdrawal of government deposits												
Stressed (adjusted) LA to total deposits	45.0	49.6	38.9	43.8	38.2	49.6	39.2					
Number of banks with liquid assets (LA) below 10 percent of deposits	2	0	1	1	1	0	1					
Asset share of banks with LA below 10 percent of deposits	8.1	0.0	5.7	2.4	2.4	0.0	5.7					
Number of banks running out of LA	0	0	0	0	0	0	0					
Asset share of banks running out of LA	0	0	0	0	0	0	0					

Source: IMF staff estimates.

1/ The table reports the stress test results for the banking system and for various peer groups formed by asset size and ownership.
2/ Adjusted by the mission to address some of the identified loan misclassifications and insider lending.
3/ Nonperforming loans currently classified as substandard and doubtful loans migrate to loss.
4/ In addition to the baseline migration of NPLs, 11 percent of current loans migrate to loss.
5/ The scenario implies that NPLs increase by approximately 50 percent at end-March 2012 relative to March 2010 levels. The currency is assumed to depreciate by 15 percent and lending rates to decline by approximately 200 basis points relative to March 2010 levels.
6/ Liquid assets in domestic currency, including cash, balances with BOG and t-bills.

Addressing the vulnerabilities

36. **The authorities have taken steps to mitigate immediate risks to financial stability.** The government recently repaid the bulk of its arrears that contributed to NPLs in the banking sector and management of SBs has been strengthened. Commercial banks raised additional capital and some were acquired by stronger banks, as part of banks' efforts to comply with the new minimum capital requirement that became effective in December 2010. There have also been some efforts by banks to appropriately classify and provision for identified NPLs and to intensify debt recovery efforts. These actions have significantly reduced the incidence of undercapitalization in the banking system. The decline in t-bill rates has also helped reduce funding costs, while the banks continued to benefit from high interest rates on their holdings of long-term bonds and loans.

37. **However, notwithstanding the recent steps, underlying vulnerabilities identified by the FSAP team remain.** The repayment of government arrears and recapitalization of banks only achieves temporal balance, and long-term stability will require improved risk management by commercial banks, strengthened supervision and better risk analysis by the regulator, and an arm's length relationship between SBs and the government. Government arrears will also continue to be a lingering risk to banks' asset quality until fiscal management is improved. Further progress is also needed to complete the resolution of remaining fragile banks and to repay the remaining government related arrears which continue to be significant for a few selected banks. The capital raised by some of the banks needs to be verified to ascertain its quality and availability.

38. **There is, therefore, a need to build on the current achievements and expedite reforms to strengthen controls and risk management at commercial banks.** Commercial banks should be immediately required to strengthen their internal controls and risk management practices, including strengthening their credit risk assessment, legal perfection of collateral, monitoring, and collection systems as well as debt collection. In selected cases, the banks will need to undertake balance sheet restructuring and develop credible business models. The BOG should issue guidelines on risk management practices and corporate governance and rigorously enforce them as well as assess the viability of banks' business models as part of the regular oversight.

39. **There is also a need to address regulatory and supervisory gaps more comprehensively.** The BCP assessment provides a detailed review of the gaps and shortcomings in the regulatory framework and in supervisory practices.[14] To avoid the potential for disorderly exit of banks, the Banking Act needs to be amended to give the BOG adequate options to resolve banks, such as including powers to undertake purchase and assumption. In addition, priority should be given to minimizing regulatory forbearance, addressing regulatory gaps, strengthening the crisis management framework, and enhancing both the supervisory

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[14] The BCP ROSC is attached as Appendix VI.

resources and expertise. Central bank independence should be further strengthened by removing the appeal provision under which the BOG decisions can be overturned by the minister and by reducing the BOG's equity stakes in commercial banks. Actions are also needed to: (i) strengthen licensing procedures; (ii) enforce accounting and auditing regulations; and (iii) address weaknesses in the collection and analysis of data for offsite surveillance and risk analysis. Given the increasing importance of conglomerates and foreign banks, there is need to strengthen consolidated supervision and cross-border supervision.

40. **The recent decision to establish a Financial Stability Department is a positive development that should help strengthen the macroprudential framework for systemic risks analysis.** Though the BOG has been undertaking some analysis of financial stability, the report has been very limited in its scope with inadequate data to undertake comprehensive analysis of risks in the banking system and the broader financial system. The work has been under resourced with considerable scope for capacity building in techniques of analysis, including stress testing and other early warning systems. It is, therefore, important that the authorities build on the recent progress to expedite the production of a comprehensive Financial Stability Report on a regular cycle that helps identify incipient problems and facilitates timely action. Concerted actions will be needed to train the staff, develop adequate data base for analysis, and establish a communication strategy.

41. **Second-generation reforms are needed to make the financial infrastructures operational and efficient.** Appropriate enforcement mechanisms are needed to ensure compliance with the International Financial Reporting Standards (IFRS) to improve financial reporting. Operations of the credit registry could be improved by enforcing lender compliance with the Credit Reporting Act and strengthening oversight of data quality. Further reforms are needed in the legislative and institutional framework for insolvency and creditor rights to address weaknesses in the network of registries and improve the efficiency of commercial courts. In particular, the judicial system will need to fast-track dispute resolutions and send a message of zero tolerance in order to discourage a culture of nonpayment of obligations.

42. **Long-term stability of the banking sector will require a paradigm shift in state involvement in the financial sector.** The FINSSIP, which is currently under discussion, provide a good opportunity to develop a clear policy and strategy for revisiting the current state involvement in the banking industry. In particular, the BOG needs to develop a credible exit strategy for its shareholding in commercial banks, as the recent decision to transfer of BOG's shares into a trust does not address the conflict of interest arising from its position as the regulator for banks. The government should also preferably divest its shareholding in the banks or at least separate the ownership from management so that the banks operate on commercial basis. Development-oriented banking activities should be financed using specialized institutions that have appropriate liability structures and do not put depositors' funds at risk. The conflict of interest created by the majority shareholding in banks by the SSNIT and its role as custodian of pension funds also needs to be addressed.

B. The Regulatory and Supervisory Framework

43. **The BOG has been making efforts to align its regulatory and supervisory framework with international standards, but important gaps remain.** Since the 2003 FSAP Update, several legislative improvements have been introduced. Effort was also made to improve risk-based supervision as a precursor to implementing Basel II, which is slated for introduction by June 2012. However, despite major accomplishments on the legislative front and the efforts to strengthen supervision, the level of non-compliance with Basel Core Principles is high. Enforcement of prudential regulations was also found to be weak.

44. **A major reform effort is, therefore, still needed to strengthen banking supervision as detailed in Appendix I and VI**. In particular, there is a need to address the deficiencies identified in risk management regulations, supervisory response times, and cross-border supervision. Current efforts to issue regulations, guidelines and examination manuals should be expedited and a comprehensive work program should be developed. Some risks in the banking system, such as interest rate risk and information technology (IT) operational risk, will need to be properly addressed and in-house expertise will need to be developed. The planned adoption of the standardized approach of the Basel II framework should not proceed without meeting certain pre-conditions. The transition to Basel II will require sound project management by the BOG, including extensive technical analysis and some policy decisions.

C. Systemic Liquidity Management and Financial Markets

45. **The BOG has significantly strengthened its liquidity management framework.** Currently monetary policy is conducted within a "lite" inflation targeting framework. The BOG has an adequate range of instruments to withdraw and inject liquidity.[15] A clear and well documented liquidity forecasting framework provides a basis for conducting open market operations. Auctions for government securities are transparent and well managed with volumes now set consistently throughout the quarter. Open Market Operations (OMOs) are conducted to manage day-to-day liquidity and are underpinned by a flexible exchange rate regime.

46. **Nevertheless, there is scope for further improvement and some of the practices deserve to be discontinued.** The penalty rate is low and the current practice of lending without collateral exposes the BOG to counterparty risk. Improvements are needed in forecasting government expenditures to minimize forecasting errors in liquidity management.

47. **Further efforts are needed to also deepen the financial markets.** The primary market in government securities operates well, but there is little secondary trading. The absence of a secondary debt market necessitated the BOG to discount bills for foreign investors who needed to exit the market during the financial crisis and while this did not impact the

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[15] The monetary instruments include a cash reserve requirement of 9 percent for foreign currency and domestic currency liability maintained in U.S. dollars and cedis, respectively. Banks are allowed to maintain a single account for the reserve requirement and for clearing and settlement.

stability of the financial system, it complicated liquidity management.[16] There is, therefore, a need to create an enabling environment for the development of a secondary market. The authorities' recent decision to reduce the number of primary dealers (PDs) and to require them to underwrite the auctions and provide market-making services is a positive development that should contribute to the development of the market. Consideration should also be given to the issuance of benchmark bonds; and the reopening of bond issues.

48. **The interbank money market has continued to grow but there is a need to address the high counterparty risks which undermines its efficient functioning and development.** All the banks participate in the markets and volumes have been increasing, but almost all transactions are overnight and secured. Banks have a conservative approach in allocating unsecured credit lines and there are selected cases where the banks would not trade even with security. Improved regulatory oversight that enhances the stability of banks could improve confidence and help market development.

49. **The foreign exchange interbank market is very small and illiquid.** The interbank foreign exchange market is a hybrid of wholesale and retail trading comprising the BOG, the commercial banks, corporate entities, importers, exporters, and individuals. Two public institutions are also prominent on the banks' foreign exchange market. The existing interbank (wholesale) foreign exchange market is not very active. There is need to develop a foreign exchange interbank market and to consider policies that can lead to greater inflows into the market to increase depth.

50. **Liquidity management has been well supported by the RTGS system but further improvements are needed for it to operate efficiently and minimize settlement risk.** There is need for the BOG to refine the intraday facility by linking the RTGS to the CSD in order to reduce the delays caused by the collateral management process.

51. **BOG's role as LOLR needs further improvements.** The BOG has legal powers to provide exceptional liquidity assistance against collateral, including government securities. However, there are no clear implementing guidelines to guide the BOG in determining whether, when, to what extent, or under what conditions it should provide support to distressed financing institutions, including deposit-taking NBFIs. The mission, therefore, recommended that the BOG expeditiously develop comprehensive LOLR policies, guidelines, and procedures. It also recommended prohibiting the BOG from lending to insolvent banks.

D. Financial Safety Nets and Crisis Preparedness

52. **Several important elements of the crisis prevention and management framework are not in place.** In addition to the weaknesses identified with respect to the LOLR, Ghana does not have: (i) adequate resolution options; (ii) a deposit insurance scheme; (iii) formal

[16] In the run up to the financial crisis, foreign investors held more than 15 percent of government securities and about half of the three to five-year paper.

procedures and contingency plans for information sharing and coordination of activities; and (iv) procedures for communication across different responsible authorities at home and abroad.

Bank resolution

53. **The BOG has an array of legal instruments and enforcement powers to handle troubled institutions.**[17] It has powers to take remedial measures against institutions under stress, appoint an advisor to bank management, appoint a conservator, revoke the license of a bank, declare a moratorium, and appoint a liquidator. It also has blanket powers to "facilitate mergers, wind up or take whatever action is needed" (Banking Act, section 28).

54. **Nevertheless, the legal framework could benefit from further strengthening and clarity.** The remedial powers of the BOG, specified in Article 60 (b), could be expanded to include additional provisions as detailed in Appendix I. The blanket provision exposes the BOG to potential legal challenges from shareholders of the bank and can lead to inconsistencies in interpretation and implementation by the supervisors, thus it is important that the law enumerates the BOG's powers and the conditions under which the powers can be used. In particular, the BOG should have powers such as purchase and assumption that will enable it to intervene in insolvent banks without consent of court and current shareholders, subject to appropriate safeguards that protect shareholder and creditor rights if the bank is liquidated.[18]

55. **Ghana's regime for prompt corrective action also needs strengthening.** The provision that allows the BOG to revoke a license when all the capital is exhausted is too lax and the BOG's ability to take timely action could be undermined by Article 62 which gives the banks six-months to remedy capital shortfalls. Potential contradictions in the legal provisions should be addressed and the BOG should be able to deploy its resolution powers and override shareholders and creditors rights prior to exhausting the capital. The mission recommended enforcing prudential regulations and to increase the capital adequacy trigger for intervention to about 4 percent.

56. **Bank resolution capability will also need to be strengthened.** Operating and implementing the legislation entails some practical challenges. Special bank resolution regimes and legal devices designed to contain the systemic effects of financial firm failure (netting, financial collateral, settlement finality, etc.) all essentially operate as a derogation from a country's ordinary insolvency laws. Staff of the resolution authorities as well as others that may be involved (e.g., in collateral registries) will, therefore, need considerable insolvency expertise. The current weaknesses in the legal framework in terms of insolvency and creditor rights suggest a need for capacity building and external expertise can be used in the interim.

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[17] The powers are stipulated in the Banking Act (Articles 13, 14, 15, 28, 60A, 60B, 62, 67, and 68). The Insolvency Act on the other hand, stipulates how a liquidator shall carry out the liquidations but in its current formulation it offers little scope for any rehabilitative action to formally take place.

[18] The recent introduction of conservatorship is useful, but not sufficient for bank resolution since conservators cannot take decisions on behalf of shareholders.

Deposit insurance

57. **The mission welcomes the authorities' interest in introducing a deposit insurance scheme but cautions that several important preconditions would have to be met.**[19] In particular, the authorities should give priority to bank resolution issues to avoid introducing distortions in the incentive structure for banks. The design of the scheme should seek to minimize moral hazard and adhere to the principles outlined by the Basel Committee on Banking Supervision (BCBS) and the International Association of Deposit Insurers (IADI). In any event, the deposit insurance should not substitute for the need to strengthen supervision or to take timely remedial actions.

Contingency crisis management arrangements

58. **Ghana does not yet have an established mechanism to deal with a systemic crisis.** Some initiatives have been undertaken to establish relationships with foreign supervisory agencies through the adoption of memoranda of understanding (MOU). However, the MOUs only cover five Nigerian banks and there are no arrangements with supervisors of the other eight foreign banks. The MOUs also do not cover essential elements for crisis management, such as mutual communication of early warning triggers and indicators or the criteria for burden sharing and emergency liquidity assistance.

59. **The mission, therefore, recommended establishing a framework for managing financial crises at the domestic, regional, and international level.** The plan should provide clear principles, policies, and procedures for handling a systemic crisis. To ensure an orderly exit, the framework should clarify the following key elements: (i) any available form of government intervention or assistance to banks and depositors; (ii) appropriate funding structures; (iii) the responsibilities for the various public and private sector stake-holders, including the BOG and the MOF; (iv) the role of the planned deposit protection scheme; (v) the role of liquidators; (vi) the role of the courts; and (vii) other government action. The design of the framework should involve high level officials to ensure timely decision making. At the regional and international level, crisis management will require coordination of home and host supervisors and more effective information sharing.

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[19] The authorities recently signed a contract with a consulting firm to undertake a feasibility analysis for the establishment of the deposit insurance.

III. Cross-Cutting Issues

A. The Social Security National Investment Trust Dominance in the Financial Sector

60. **The SSNIT holds a central position within the financial sector.** It is currently the main provider of pensions in Ghana. It also has significant shareholding in 9 of the 26 commercial banks, majority shareholding in two of the banks, and holds a significant level of deposits in the banking system. In the capital markets, it holds positions in 22 of the 34 companies listed on the stock exchange and accounts for over 81 percent of local funds under management.[20] The SSNIT also holds equity in two insurance companies, including one of the largest insurance companies. It also acts as a primary dealer in the t- bill market.

61. **SSNIT's sizeable portfolio in a thin market introduces distortions that deserve careful consideration.** Currently, the SSNIT has majority shareholding in two of the problem banks which creates a conflict with its role as custodian of pension funds. The SSNIT does not also seem to have clear exit strategies from investments. The current concentration of SSNIT's deposits in the small and weak banks raises questions about its contribution to efficient intermediation.

B. Anti-Money Laundering and Combating Financing of Terrorism

62. **Ghana has put in place most of the basic elements for a comprehensive AML/CFT framework, but it is not yet compliant with most core and key FATF recommendations.**[21] The main deficiencies identified related to the absence of an implementation law and regulations particularly in relation to CSD, record-keeping, and the absence of an operational Financial Intelligence Unit. The authorities have begun to address identified deficiencies, but the agenda for further action is large. Compliance with the FATF standards will depend on the expeditious implementation of the national action plan, budgetary allocation for implementation, and training.

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[20] As at December 2010, the SSNIT held assets valued at ₡ 2,738.8 million (US$1.88 billion) representing 6 percent of GDP. The SSNIT held 3.3 percent of the total market and 12 percent of the banking sector capitalization at the GSE in June 2010. When the free float market capitalization is taken into account, the SSNIT effectively held over 40 percent of the float at the GSE.

[21] The assessment was undertaken by the AML/CFT regional group for West Africa. For more details see the 2009 GIABA Mutual Evaluation Report (MER) Available at http://www.giaba.org/.

IV. Structural and Developmental Challenges

A. Long-Term Finance

63. **The nonbanking sector has registered rapid growth, but long-term finance remains scarce.** The sectors exhibit common deficiencies in regulation, supervision, and supporting financial infrastructures.

Capital markets

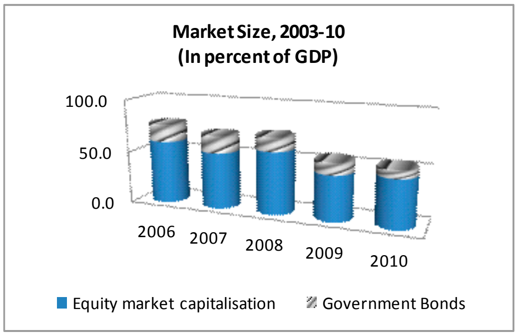
64. **The Ghanaian securities industry has not played a major role in resource mobilization and long-term financing of the economy.** Equities dominate the industry and the debt market consists predominantly of government securities. Though the industry has grown rapidly, the market lacks depth and liquidity, in part due to low float. Only 34 companies are listed. The corporate debt market is at a nascent stage with a single outstanding issue of about US$3.9 million and a few privately placed bonds.[22] Collective investment schemes (CIS) are gaining importance. Overall, the market is very concentrated (Figure 5).

65. **The authorities have been implementing reforms to develop the market, but important challenges remain**. A new automated trading system and the clearing and settlement systems for equities and for government securities have been put in place. The PD system was recently reformed to reduce the number and improve capitalization. However, regulation and supervision is inadequate and minimum capital is too low. The SEC has limited capacity to regulate the broadening market due to a public sector recruitment freeze and the inability to attract and retain competent staff due to low remuneration. The SEC's independence is also compromised by inadequate funding. Further, none of the post trade infrastructure was achieving DVP, thus introducing settlement risk. Further development of the market will require efforts to strengthen regulatory oversight and improve efficiency and transparency (see Appendix I for detailed recommendations and the technical note for more detailed analysis).

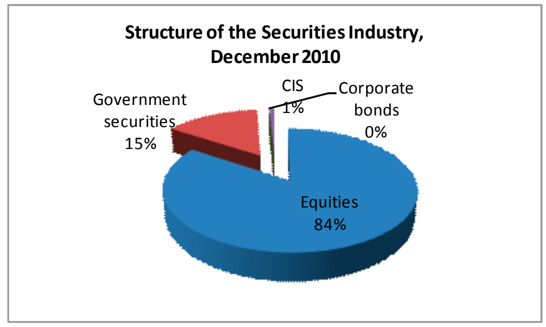
[22] Corporate bonds have not picked up in part due to a cumbersome primary issuance framework, lack of a liquid benchmark treasury yield curve, concentrated investor base, and a high inflation and high interest rate environment.

Figure 5. Ghana: Structure and Performance of Capital Markets, 2003–10

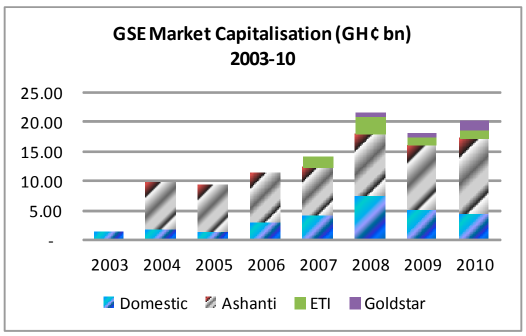
Ghana's capital markets are still small...



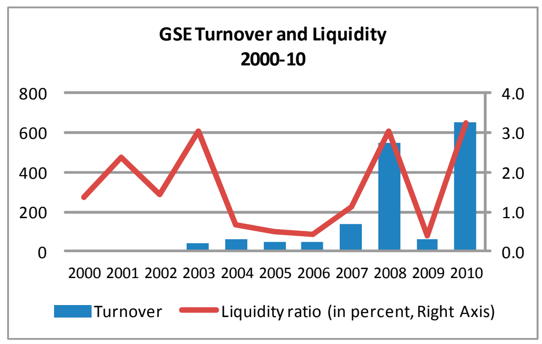
and are dominated by the equities market....



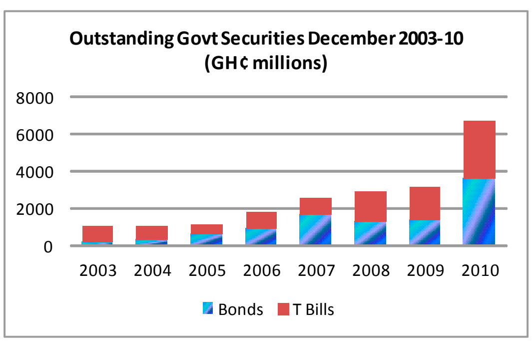
But the domestic component of the equity market is small...



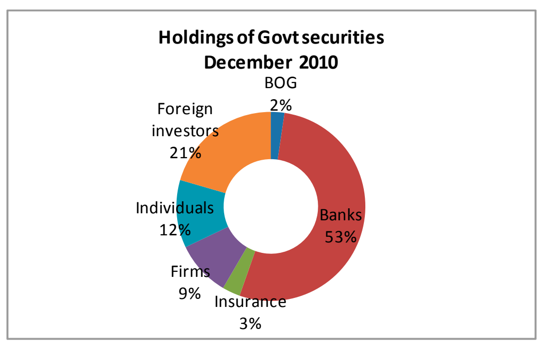
and the market lacks liquidity, in part due to low float...



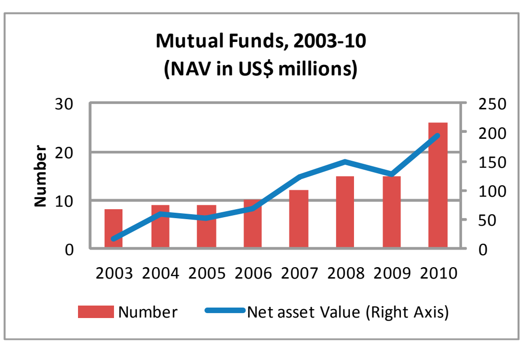
Long term bonds have increased their share in a growing market..



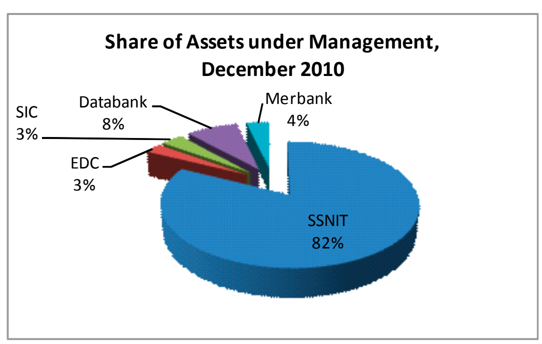
and while banks hold the bulk of the securities...
foreign investment is significant.



The CIS industry is gaining in importance....



..but the investor base is heavily dominated by SSNIT...



Sources: Ghana Stock Exchange and Securities Commission.

Insurance industry

66. **The insurance industry faces important developmental challenges.** Despite a rapid growth in the number of players, penetration ratios are low due in part to low incomes, high illiteracy levels, dominance of the informal sector, poor image of insurance companies, and inadequate public education. Minimum capital requirements for both life and non-life are low by international and regional standards and encourage entry of companies with insufficient start-up capital to generate profitable business volumes.[23] The widespread practice of discounting premiums results in the companies not being able to honor claims. The level of unpaid premiums has reportedly increased from 25 percent to 45 percent over the last five years which is adversely affecting the profitability, liquidity, and solvency of companies. Regulation and supervision have not kept pace with industry growth and practices. Other challenges facing the industry are the high expense ratio, incidence of fraudulent claims, inadequate technology, and inadequate supply of skilled personnel.

67. **To ensure viability of the industry, regulation and supervision should be strengthened.** Both supervisory resources and expertise need to be increased. Minimum capital requirements should be increased to at least US$5 million for life companies. The National Insurance Commission (NIC) has recently introduced an initiative under which insured parties must either pay cash up front or enter into a credit agreement, thus NIC should monitor the level of outstanding premiums and use it to prioritize its onsite activity. The NIC should also consider requiring companies to report instances where insured parties have defaulted to the Credit Bureau and to pay attention to ensuring that premiums are set at economically sustainable levels.

Pension funds

68. **The shift to a three-tier pension system is welcome but further reforms are needed to address gaps in the Pension Act.** The pension reforms are expected to break SSNITs virtual monopoly, improve benefits, and extend coverage voluntarily to the informal sector. However, the act needs to (i) incorporate the IOPS principles; (ii) increase the operational autonomy and accountability in the appointment and removal of members of the Board as well as ensure financial independence in the provision of budgetary resources; (iii) introduce implementation regulations and guidelines; (iv) clarify the legal status of the guidelines as enforceable instruments; (v) provide guidelines governing the relationship between trustees and third parties; (vi) prohibit approved trustees investing in the securities of a company that has sponsored the formation of the scheme; (vii) specify the minimum terms of outsourcing contracts and give the supervisor access to third parties; and (viii) expedite plans to enter into MOUs with the relevant supervisors for exchange of information.

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[23] The minimum capital requirement for both life and non-life are the cedi equivalent of US$1 million and for reinsurers the equivalent of US$2.5 million. International best practices suggest that US$5 million is appropriate for non-life companies, US$10 million for life companies and reinsurers with capital at least three times that of insurers.

B. Access to Financial Services

69. **Despite recent gains, access to financial services is still limited and intermediation costs are high due to a range of structural and other constraints**. This applies to a broad spectrum of products including microfinance, housing, agriculture finance, and venture capital. In particular:

- The microfinance sector has been expanding without a regulatory framework, the micro finance institutions (MFIs) are financially weak and undercapitalized; and the borrowers are highly indebted.

- The housing sector faces a supply shortage which has fuelled house price inflation due to interlinked challenges such as problems with land titling and limited access to finance.

- The high risk embedded in agriculture finance has discouraged private sector involvement while government programs have been prone to repayment problems and have also tended to erode credit discipline across the value chain.

- Mobile payment services are fairly new and have not yet achieved the objective of extending payment services to outlying areas and un-banked communities.

- Venture capital is not yet a major source of financing in Ghana, in part due to a shortage of skills, inability to attract private sector funding, and a discriminatory tax regime that favors government programs.

- The leasing industry is still very small and requires further reforms to grow.

70. **Further efforts are therefore needed to develop the sectors and to improve efficiency.** The authorities concur with the mission's assessment that there is a need to review the current architecture for oversight of the micro finance sector. The mission further recommended developing a policy and guidelines for: (i) the underwriting of microcredit risk; (ii) increasing minimum capital of MFIs; and (iii) reviewing the incentive structure created by the government's involvement in the various sectors. Other recommendations are detailed in Appendix I.

V. Financial System Infrastructure

A. Payments Systems and Securities Settlement

71. **Ghana has implemented various reforms to modernize the national payment and securities settlement system.** The reforms were designed to: (i) improve efficiency and reduce risks in the payment system; (ii) deepen financial intermediation; (iii) broaden the range of payment instruments; and (iv) to develop infrastructure that supports interoperability. Significant progress has been made in introducing an electronic funds transfer systems,

reducing the check clearing time; improving efficiency in the handling of securities and equities; and strengthening the legal framework most notably with regard to oversight of the payment system (see Appendix V for details).

72. **However, despite this progress, important challenges remain for which further reforms are needed.** The main challenges relate to: (i) gaps in the regulation and oversight of the payment system; (ii) settlement risk in the retail payment stream; (iii) inadequate business continuity arrangements for the CSD; (iv) absence of a clear strategy for embracing electronic means of payment and reducing the use of cash; (v) the lack of interoperability of Automated Teller Machines and Point of Sale networks; and (vi) the absence of a systematic mechanism for engaging with stakeholders on payment system reform.

B. Insolvency and Creditor Rights

73. **Enforcing creditor rights in Ghana remains a challenge despite the steps to reform the legislative and institutional framework for insolvency and creditor rights.** The authorities implemented a number of measures, that have potential to reduce credit risk, including: (i) enacting legislation to fast track the process for foreclosing on collateral; (ii) establishing a collateral registry to register charges and collateral credited by the borrowers; (iii) enacting a credit reporting act and issuing licenses for companies to start operating credit registries; and (iv) establishing commercial courts to ensure efficient resolution of commercial disputes.

74. **Notwithstanding these steps, important challenges remain which call for additional reforms**. Procedures for taking and enforcing security are protracted, legally complex, costly, and unpredictable. There also exists a high degree of information asymmetry that leads to imprudent lending decisions due to the limitations in data captured by the credit registry. In addition, the network of registries in Ghana is complex and prone to creating disruptions in taking and enforcing security. Further reforms are, therefore, needed to the judicial and legislative framework and to make the institutions operational and efficient.

C. Auditing and Accounting

75. **Corporate financial reporting practices in Ghana are weak with important ramifications for the soundness of the banking sector and other financial institutions.** Efforts are, therefore, needed to strengthen the legal framework for accounting, to ensure compliance and quality control and to enhance the technical knowledge of the regulators, accountants, and auditors of banks in the IFRS. In particular, there is a need to enact a modern Accountants Act to provide legal backing for an arrangement to issue applicable accounting and auditing standards (IFRS and ISA), and to establish an independent oversight body to conduct audit quality assurance review of the auditors of public interest entities. [24] Banks need

[24] In this context, the experience of the South African Independent Regulatory Board for Auditors can be helpful. Organizations with similar mandates in some other countries are: The Public Company Accounting

(continued)

to establish appropriate accounting and information systems to comply with IFRS requirements. All relevant regulators need to strengthen technical capacity concerning the IFRS.

Oversight Board in the United States, the Financial Reporting Council in the United Kingdom, and the Financial Reporting council in Mauritius.

Appendix I. Detailed Recommendations

Recommendation	Counterpart	Timing
Banking Sector		
Complete the repayment of government arrears.	MOF	Immediate
Complete the resolution of problematic banks	BOG/MOF/SSNIT	
• Prepare a manual that specifies the scope of the audits to be undertaken.	BOG	Immediate
• Commission an audit to ascertain the true financial condition of the banks in question and viability of their business models.	BOG	Soon after the manual is completed
• Undertake a targeted amendment of the Banking Act to address gaps in the resolution options, such as to undertake purchase and assumption.	BOG/GOG	Immediately and in tandem with the audit
• Establish a Steering Committee to deal with problem banks pending to establish a comprehensive framework for crisis management.	BOG/MOF/MOJ/and other immediately relevant regulators	Immediate and before the audit
Develop a comprehensive framework for crisis management.	BOG/MOF/NIC/SEC	Short to medium term
Strengthen systemic risk analysis • Strengthen the human resource envelop for the newly established Financial Stability Department. • Address data gaps for risk analysis. • Provide training in techniques for systemic risk analysis, including stress testing.	BOG	Immediate
Strengthen banking supervision • Design an effective exit strategy for divesting BOG shareholding in banks. • Discontinue regulatory forbearance. • Amend the Banking Act to comprehensively address all identified regulatory gaps that undermine the BOGs operational independence, supervisory and enforcement powers, including revoking the provision to appeal to the minister, empowering the BOG undertake consolidated supervision; and increasing capital threshold for revoking the license. • Strengthen licensing procedures to ensure that only sound and health banks with "supervisable" structures or strong home supervisors enter the market. • Establish guidelines to enhance risk management in the industry. • Strengthen supervisory processes and capacity to ensure effective risk-based supervision. • Expedite efforts to effectively undertake cross-border supervision and consolidated supervision, of which the establishment of a formal Interagency Committee is part	BOG	Immediate

Recommendation	Counterpart	Timing
and formalization of the MOU with host supervisors.		
Amend section 60 (b) of the Banking Act to include the following clause: (i) Dispose of fixed assets such as real estate and equity holdings; (ii) Cease additional payments such as honorary payments, bonus, premium, in kind or in cash social aids to the members of the Board of Directors, general manager, and assistant general managers and other key staff; (iii) Limit or end the operations which cause losses; (iv) Liquidate the assets which have low efficiency or are inefficient to restrict the operations of the bank in such manner as to cover its whole organization or only those of its branches which will be considered necessary or its relations with correspondent banks; and (v) Impose stricter prudential ratios than that generally applies.	BOG/GOG	As part of amendments to the Banking Act
Strictly enforce loan classification to avoid ever-greening of loans.	BOG	Immediate
Require banks to reflect restructured loans as part of impaired assets.	BOG	Immediate
Implement policy and plan to regulate and supervise financial groups.	BOG	Immediate
Address gaps in the MOU for rapid implementation of cross-border and cross-sector supervisory arrangements.	BOG/Home Supervisor	Short term
Use current licensing powers to update information of shareholders and ultimate beneficiaries to support both solo and group supervision.	BOG	Immediate
Improve quality of data base, analysis, and reporting.	BOG	Immediate
Insurance		
Raise minimum capital requirement to ensure financial sound companies that can provide effective competition and increased business volumes.	GOG	Short term
Strengthen the regulatory and supervisory capacity, both in terms of resources and skill mix.	NIC	Medium term
Establish an MOU with pension regulator.	NIC/NPRA	Immediate
Address market concerns on discounting and premium withholding.	NIC	Immediate
Pensions		
Enact regulations.	GOG	Immediate
Finalize guidelines.	NPRA	Immediate
Establish MOUs with the SEC and the NIC.	NPRA	Immediate
Review the NPRA against the IOPS principles.	GOG	Medium term

Capital markets		
Build SEC's capacity both in numbers and quality of staff, review its terms of service by benchmarking it to appropriate regulatory authorities in the financial sector and ensuring its independence.	SEC/MOF	Immediate
Raise minimum capital requirement for intermediaries, differentiated between activities undertaken by licensees.	SEC	Short term
Review the securities industry laws to modernize them and meet compliance with the IOSCO's principles.	SEC	Medium term
Promote new equity listings by domestic companies and prioritize privatization or divesture from the profitable SOEs through the capital markets.	MOF	Medium term
Introduce a separate and more flexible framework for the issuance of nongovernment bonds.	SEC	Short term
Implement DvP for securities settlement at the two CSDs.	SEC/MOF/BOG	Immediate
Introduce multiple settlement banks at the CSD in order to manage the concentration risk and aim to have the BOG as the final settlement bank.	SEC/GSE/BOG	Immediate
Enforce post trade transparency for government bonds by requiring trade reporting of over-the-counter trades to a central place, preferably the GSE, within a specified time for dissemination to the wider public.	SEC	Short term
Support the establishment of a locally-based credit rating agency in Ghana.	SEC/MOF	Medium term
Formalize coordination between regulators through an MOU.	SEC/NIC/NPC/BOG	Immediate
Implement the demutualization of the GSE.	SEC/GSE/MOF	Medium term
Payment system		
Establish interoperability within the banking industry.	BOG/Industry	Medium
Establish the National Payment Systems (NPS) Unit as a fully fledged, stand alone department to pay undivided attention to NPS issues.	BOG	Medium
Create proper regulations to oversee payment service providers.	BOG	Short term
Link the RTGS system and the CSD to achieve a DvP and address potential settlement risks for securities transactions and retail payment streams.	BOG	Immediate
Establish a disaster recovery site for the CSD system.	BOG	Immediate
Review legal framework to ensure consistency adequacy in supporting current and future payment systems developments.	BOG/GOG	Immediate
Build payment systems capacity.	BOG	Immediate
AML/CFT		
Pass the economic and organized crime bill.	Parliament	Immediate
Implement the recommendations of the National AML/CFT Action Plan.	MOF, BOG, SEC, NIC	Immediate
Provide adequate resources to the FIC.	MOF	Immediate
Strengthen supervision for AML/CFT in all sectors.	BOG, SEC, NIC	Immediate

Address GIABA's assessment report recommendations.	MOF, BOG, SEC, NIC	Immediate
Insolvency and Creditor Rights		
Clarify the tax treatment of leasing contracts.	IRS	Short term
Increase compliance with the Credit Reporting Act 2007 to encourage the provision of data and the actual use by lenders of credit reference bureaus in Ghana.	BOG/SEC	Short term
Take steps to enhance automation and coordination of all charge registries in Ghana.		Medium term
Review the civil procedure rules to further increase speed and efficiency of judicial proceedings.	MOJ	Medium term
Increase judicial capacity and training.	MOJ	Medium term
Reform the Bodies Corporate Official Liquidations Act 1963, including procedures for corporate rehabilitation.	MOJ	Short term
Develop a body of practitioners to assist in insolvency cases, together with an organized system for their training and accreditation.	MOJ	Medium term
Systemic Liquidity Management		
Further improve liquidity forecasting particularly with respect to government expenditures.	BOG	Immediate
Consider increasing the penalty rates for the discount window and the access procedures.	BOG	Medium
Establish a plan for developing the interbank foreign exchange market.	BOG	Immediate
Reform the primary dealer system for t-bills by limiting the number and require underwriting standards for the PDs.	BOG	Medium term
Consider introducing an intraday facility.	BOG	Medium term
Housing		
Reform the titling system (including securing of restructuring of Lands Commission).	Ministry of Land Administration, Forestry and Mines and Lands Commission	Medium term
Identify options with domestic construction industry to increase the supply of affordable and bankable housing.	Ministry of Water Resources, Works and Housing; Ministry of Finance and Economic Development	Medium term
Assessment of commercial logic and fiscal implications of proposed deal with the Korean Government and the Korean construction firm for the construction of 200,000 housing units.	Ministry of Water Resources, Works and Housing; Ministry of Finance and Economic Development	Immediate
Enhance capacities in mortgage lending in the area of housing microfinance and access to long-term local currency funding.	BOG	Medium term
Access to Finance		
Conduct a rapid assessment of a sample of urban	BOG	Immediate

marketplaces to determine the extent of micro and small-scale borrower indebtedness.		
Instruct the Registrar General to stop registering companies that list savings or lending among their principal activities.	BOG	Immediate
Develop licensing requirements and procedures for microfinance services companies.	BOG	Short term
Develop policies and guidelines for bank and savings and loans institutions in (i) underwriting micro loans; and (ii) extending loans to any person or entity for the purpose of on lending those funds to others. Train supervisors in the onsite and offsite enforcement of these policies and guidelines.	BOG	Short term
Require savings and loans to submit the same data that is required of banks, and make public the same data for savings and loans that is made public for banks.	BOG	Short term
Develop a framework and timeline to gradually harmonize or rationalize the prudential requirements and permitted products of RCBs and savings and loans, with a view toward the development of a “small savings and loans” type of institution requiring minimum capital in the US$2–3 million range.	BOG	Short term
Develop a timeline for gradually increasing the minimum capital requirement for RCBs and facilitating their transformation into the “small savings and loans” type of institution.	BOG	Short term
Outsource to an independent third party the auditing and development of shareholder registries for all of the RCBs to facilitate their consolidation and, where necessary, resolution.	BOG	Immediate
Contract international experts to assist in the development of a legal and regulatory framework for CUs.	BOG	Short term
Develop a plan and budget for potential donor funding to strengthen the credit unions and the CUA.	BOG	Medium
Conduct an audit of all government programs providing lines of credit or guarantees to financial institutions and develop a plan to close poorly performing programs.	BOG	Short term
Create a secondary debt market and facilitate the sale of nonperforming assets created by targeted lending programs.	BOG	Medium term
Evaluate the constraints, including government ownership of storage facilities, and develop an action plan to facilitate the development of a warehouse receipting system.	MOF	Short term
Begin an inclusive dialogue with relevant GOG institutions and the private sector on the role of the government in the agricultural commodities markets.	MOF	Short term

Appendix II. Implementation Status of 2003 FSAP Recommendations

Principal Recommendations	Observations
Banking Supervision • Review banks' risk management approaches, and take remedial actions as needed. • Improve corporate governance and financial reporting of state owned banks. • Ensure timely payment of the government's obligations.	• The BOG is in the process of drafting prudential regulations and guidelines that will set standards for risk management in banks. • The government has replaced the management in the state banks with experienced and qualified personnel • Arrears were recently paid but new arrears have already accumulated.
Insurance Supervision • Introduce updated insurance legislation, addressing the need to reinforce the powers of the National Insurance Commission. • Strengthen supervisory practices, including: inspection powers; prudential reporting; and mechanisms to liquidate weak insurance companies.	• New legislation was passed in December 2006 (Insurance Act 2006 (724)) and a review of this law is already in the pipeline. • A task force was established in 2003 to improve prudential reporting and conduct regular onsite inspections but significant deficiencies persist. The 2006 Act gives the NIC powers to regulate, supervise and monitor all these areas.
Securities Regulation • Concentrate oversight of all securities activities, including in t-bills, in the Securities Exchange Commission (SEC).	• SEC still lacks authority over government securities and it has inadequate supervisory capacity.
Legal and Judicial System • Introduce a strong legislative framework against money laundering. • Improve the effectiveness of the rules on contract enforcement, security, and collateral foreclosure, and the effectiveness of court procedures. • Introduce a suitable legal framework to facilitate the operation of credit reference bureaus.	• Legislation was recently issued. • The following were established (a collateral registry; commercial courts, and fast track procedures for realizing collateral) but there are still challenges in actual implementation. • The law was passed and a credit reference bureau was licensed and has started operating. Licenses have been issued for two others.
Bank of Ghana • Strengthen the BOG's capital by replacing government receivables with t-bills and longer-term government securities • Liquidate BOG ownership in banks.	• No change. • Not done, instead BOG shareholding has increased in NIB as well. In addition, the creation of a trust to manage the portfolio does not address the conflict of interest.

Appendix III. Risk Assessment Matrix[25]

Nature/Source of Main Threats	Overall Level of Concern: Likelihood of Severe Realization of Threat Sometime in the next Three Years	Overall Level of Concern: Expected Impact on Financial Stability if Threat is Realized
Macroeconomic risks		
Inability to reduce or contain fiscal deficits	Assessment: High • Efforts to strengthen fiscal management have been slow new arrears are reported to have emerged. • The current high fiscal deficit of 7.7 percent poses some challenges and prospects of creating the fiscal space in the near term are uncertain as the potential for expenditure overruns are high ahead of the 2012 elections.	Assessment: High • The accumulation of new arrears could compound the NPL problem and weaken banks. • High fiscal deficits could lead to high interest rates and engender a further deterioration in bank assets, profits, and capital.[26]
Surges in capital inflows	Assessment: High • The start of oil production is attracting substantial capital flows into Ghana, including portfolio, foreign direct investment and other capital flows.	Assessment: High • The increase in banking system liquidity, from the surges in capital flows, strong balance of payments performance and the expansionary fiscal policy could encourage greater risk taking, especially given the recent increase in minimum capital. This could set the stage for subsequent asset deterioration.
Bank-Specific Factors		
Insolvency of a regional banking group	Assessment: High • The probability of banking problems in regional groups is heightened by the phenomenal pace of cross-border expansion against a background of weaknesses in consolidated supervision of banking groups; gaps in cross-border supervision; weaknesses in accounting practices by banks; and deficiencies in surveillance and in information sharing arrangements between home and host	Assessment: Medium • Confidence in banks perceived to be in a similar class would be eroded and this could engender deposit runs that lead to broader banking problems. • Selected banks could incur losses on their intra-group exposures that erode the bank capital.

[25] The impact of these shocks are quantified in Table 3, discussed in paragraph 29–35, and further detailed in Appendix IV.

[26] The probability of defaulting on the government bonds is extremely low, particularly given the rising prices of oil exports.

Nature/Source of Main Threats	Overall Level of Concern	
	Likelihood of Severe Realization of Threat Sometime in the next Three Years	Expected Impact on Financial Stability if Threat is Realized
	supervisors.	
Insolvency of securities firms or rapid net redemptions in mutual funds	Assessment: Medium • Probability of cross sector contagion is a lingering risk as nine banks accounting for 53 percent of banking system assets have subsidiaries, mostly in securities. The securities industry is less well regulated and groups are not supervised on consolidated supervision.	Assessment: Medium • Available data was not adequate to quantify the impact but selected banks could experience liquidity problems if their securities subsidiaries experience problems or mutual funds experience rapid net redemptions, as happened in 2009.
External/ Tail Risks		
Shock to cocoa prices	Assessment: Low • Cocoa prices remained relatively resilient even during the recent global financial crisis because of the low demand elasticity for food products, but a shock cannot be ruled out altogether.	Assessment: High • A decline in cocoa prices of 20 percent or more could have a system wide impact because of the multiple impacts on credit, liquidity, and exchange rate. In particular, such a decline would reduce fiscal revenues, international reserves, and deposits in the banking sector as well as increase credit risk for downstream manufacturing and licensed buying companies linked to the cocoa sectors.

Appendix IV. Stress Testing Methodology and Scenarios

76. **This appendix describes the coverage and methodology of the stress tests and discusses the results.** The stress tests were undertaken by the FSAP team for all the 26 commercial banks, individually and by groups, during the August mission using end-March 2010 data. These were later updated using data for end December 2010.

77. **The risks and magnitude of shocks that were assessed are detailed in the Appendix Table 4 below.** In both instances, the simulations sought to evaluate the impact of single and multiple shocks, but data limitations rendered it difficult to quantify some of the key macro risks and to develop macro consistent scenarios. Thus, the magnitudes reflect either historical experience or other intuitively plausible shocks. Feedback loops and other interactions that have potential to magnify the impact of the shocks are not adequately reflected in the analysis.

Appendix Table 4. Ghana: Single Factor Shocks and Macro Scenarios

Risk Type	Shocks Simulated
	Single Factor Shocks
Credit risk	Credit migration of net uncollateralized exposures across the NPL transition matrix. Scenarios involving the migration of 50 and 100 percent of "substandard" and "doubtful" loans to the next category while current and OLEM loans remain unchanged
	Credit migration on the transition matrix plus new NPLs. 100 percent of "substandard" and "doubtful" loans migrate to the next category. 11 percent of "current" loans become "doubtful," "OLEM" loans remain unchanged.
Concentration risk	Default of largest borrower with 30 percent of recovery on exposure
	Default of three largest borrowers with 30 percent recovery on exposure
Exchange rate risk	Uniform appreciation/depreciation rate of 50 percent of the cedi. Tests uses sensitivity analysis on the net open position.
Interest rate risk	A parallel shift in the yield curve of 1000 basis points. Test uses repricing gap model
Increased risk taking	Migration of assets from lower to higher risk weighted assets.
Liquidity risk	Withdrawal of the following deposits: 15 percent of SSNIT funds and 100 percent withdrawal of government deposits.
	Macro Scenarios
Fiscal scenario	Continued weaknesses in fiscal management lead to new NPLs of approximately 3 percent of GDP.
	Treasury bill and lending rates increase and foreign investors become skittish about the deteriorating macro environment and their exit triggers a rapid depreciation.
	140 percent increase in the stock of NPLs due to domestic arrears and a large depreciation. In addition, migration of 100 percent of "substandard" and "doubtful" loans to next category.
	40 percent depreciation in the cedi and 800 basis point upward shift in the yield curve.
Cross border contagion	Insolvency of one of the regional banking groups and parent defaults on the intra-group exposures.
	Confidence in the banking group declines and there is a deposit run that results in a cumulative outflow of 18 percent of the deposits.
Shock to cocoa prices	Cocoa prices decline by 20 to 40 percent, fiscal revenues decline and the deficit increases; foreign exchange reserves decline thus the exchange rate depreciates; debt service capacity of cocoa farmers and other upstream industries is eroded.
	50 percent increase in NPLs coupled with a migration of NPLs on the transition matrix.
	15 percent depreciation and 200 basis point downward shift in the yield curve.

Source: IMF estimates.

1/ The scenarios do not take into consideration banks' future profits.

2/ Exchange rate induced credit risk is assessed using panel regression analysis on the 26 banks NPLs and a set of bank specific variables and macro controls.

78. **The calibration of shocks took into account vulnerabilities in the banks' balance sheet and the environment in which they operate**. These include the fact that: (i) prospects of collecting on NPLs are weak due to difficulties in enforcing creditor rights; (ii) some impaired loans that are not yet included in NPLs because they are related to government expenditures; (iii) banks exhibit large concentrations in their loan portfolios; (iv) there is a large portfolio of foreign currency deposits and loans; (v) and there is a lot of uncertainty about the direction of interest rates.

79. **The updated stress test results indicate that the fundamental vulnerabilities remain the same, though the level of risk in the banking system is significantly lower than assessed at the time of the August mission.** The main stability risks facing Ghana's banking system are credit and concentration risks and these risks are highly interrelated. Liquidity risk is concentrated in the smaller banks. Other risks (contagion risk, market risk induced credit risk etc) are reported to be significant but would require more information to quantify. Macroeconomic shocks, such as fiscal shock or commodity prices shock to cocoa prices pose a significant risk because of simultaneous impact on interest rates, exchange rate and asset quality. In terms of groups, the vulnerabilities are more concentrated in domestic banks. Direct market risk is not significant as foreign exchange risk is minimized by the generally low open position maintained by banks and interest rate risk is mitigated by the practice of lending at variable rates.

Appendix V. Financial Sector Reforms Since 2003

Year	Nature of Reforms
Banking Sector	
2003	The universal banking license was introduced and banks with cedi 70 billion in capital were permitted to carry out any form of banking.
2004	Banking Act 2004 replaced the Banking Law 1989 while the BOG began to strengthen its risk based prudential supervision policies.
2007	Following the redenomination of the cedi (cedi 10,000=₵1), the minimum capital was increased from ₵7 million to ₵60 million. Foreign-owned banks were required to raise their minimum capital to ₵60 million by end-December 2009 while local banks have to raise the minimum capital to ₵25 million by end-December 2010 and to increase the regulatory capital to ₵60 million by end-2012.
2007	Banking Act amended to enable establishment of international financial services in Ghana and the local subsidiary of Barclays was since issued with a license to commence operations as an off-shore bank.
Nonbanking Sector	
2004	A CSD was established, certificates immobilized, and the trading system automated to increase liquidity and efficiency.
2006	The Foreign Exchange Act of 2006 (Act 723) allowed nonresidents to hold local securities and also lengthened the yield curve by issuing longer maturity.
2006	The Insurance Act of 2006 was passed which modernized many facets of insurance regulations. Though it does not yet incorporate all of the Insurance Core Principles of the International Association of Insurance Supervisors, it required composite firms to split into life and non-life.
2008	The Nonbank Financial Institutions Act, 2008; provides a framework to promote effective prudential regulation and supervision for the wide range of nonbank financial institutions. It puts all financial institutions essentially on a level regulatory playing field, reduces the scope for regulatory arbitrage, and improves the efficiency of the credit system as a whole.
Financial Infrastructure	
2003	The Payment System Act (2003) gave explicit powers to the BOG to oversee payments system. The Ghana Interbank Settlement System (RTGS) was also introduced as part of the BOG strategy to address risks inherent in check clearing.
2004	The CSD was established to handle the GOG and BOG securities.
2007	The Credit Reporting Act (Act 726) was enacted and a license issued to companies to start operating.
2007	The IFRS was introduced and all banks, insurance companies, securities brokers, pension funds and investment banks, and public institutions had to comply by the deadline of December 2007.
2007	The Central Securities Depository Act (2007) was enacted.
2008	The Borrowers and Lenders Act (2008) was enacted to provide a framework for full disclosure in creditor and borrower relations and in particular the role of collateral in the delivery of credit. The act provides a legal framework for credit, improves standards of disclosure of information by borrowers and lenders, prohibits certain credit practices, and promotes a consisted enforcement framework related to credit and related matters. The act establishes a collateral registry where charges and collateral credited by borrowers are registered. The act permits lenders to take possession of collateral security after a 30-day notice of default is served on the borrower without recourse to

Year	Nature of Reforms
	court.
2008	The Electronic Transactions Act (2008) was introduced.
2008	The second CSD, the GSE Securities Depository (GSD), a fully owned subsidiary of the GSE was established and is responsible for holding equities and corporate bonds in electronic or dematerialized form.
2008	Under the Home Mortgage Finance Act 2008 a mortgagor is deemed to be in default after three successive failures to pay required installments despite notifications. In the event of repayment default, the financial institution may take possession without recourse to court or seek police assistance through a court order to take possession of the property in the event of resistance. A possessed mortgaged property may be sold publicly or receiver may be appointed to manage the mortgaged property in the event of default and possession.
2008	A new Pension Law (National Pensions Act 2008, Act 766) has been enacted that replaces the predominantly state run pension scheme with a three-tier scheme and defines the functions of the National Pensions Regulatory Authority, the mandate of the SSNIT, and its governance structure.
2009	The Cheque Codeline Clearing (CCC) was introduced which reduced the check clearing period from 5–8 days to 2 days throughout the country. Mobile payment services were also authorized and launched.
AML/CFT	
2008	An AML Act 2008 was enacted to help improve the integrity of the financial system and key international conventions have been ratified. These include among others, the UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (The 1988 Vienna Convention) as well as the UN Convention for the Suppression of the Financing of Terrorism that has been domesticated in the 2008 Anti-Terrorism Act.

Appendix VI. Basel Core Principles Assessment—Summary

Introduction

80. **This part contains a summary assessment of Ghana's adherence to the Basel Core Principles carried out in the context of the FSAP Update mission**.[27] It updates the earlier assessment of Ghana's compliance with the BCPs that was done as part of the 2003 FSAP update. The assessment reflects the banking supervision practices of the BOG as of end-August 2010.

Information and Methodology Used for Assessment

81. **The assessment was performed in accordance with the 2006 Core principles methodology.** It is based on several sources: (i) a review of the legal and regulatory framework; (ii) review of onsite supervision reports, offsite analysis reports and licensing documentation; (iii) interviews with supervision staff of the BOG; (iv) meetings with senior officials of four commercial banks operating in Ghana; (v) interviews with two major international accounting firms that audit banks in Ghana; (vi) chief executive officers of the newly established collateral registry and the credit reference bureau; and (vii) the Ghana Association of Bankers. A self-assessment completed by the BOG was also provided.

Institutional and Macro-Prudential Setting——Market Structure

82. **The banking industry in Ghana comprises the central bank, ARB Apex Bank,[28] 26 commercial banks, 136 RCBs and two representative offices.** Twenty five of the commercial banks hold class one banking license while one bank holds a general banking license**.** Thirteen commercial banks accounting for 52 percent of the banking system assets are subsidiaries of foreign-controlled banks; and five banks (accounting for 30 percent of the banking system assets) have majority state shareholding. The state-owned banks have varying degrees of performance problems, including high NPLs, solvency, and liquidity.

General Preconditions for Effective Banking Supervision

83. **The pre-conditions for effective supervision of banks are improving but more is needed to ensure an enabling macroeconomic environment and an effective financial infrastructure**. In particular, high lending rates, operational challenges with the newly established institutions to enforce creditor rights, weaknesses in compliance with accounting and auditing standards; gaps in the safety nets and non-compliance with most of FATF principles against a background of an open capital account regime, all present challenges for

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[27] The summary is based on the *detailed* assessment undertaken as part of the FSAP by Katia d'Hulster (World Bank) and Moses Pelaelo (consultant, International Monetary Fund).

[28] ARB Apex Bank is a "mini-central bank" with a banking license (though with substantially lower minimum capital requirement) whose shareholders are the RCBs.

supervision. In addition, the current gaps in the public safety nets could render the resolution process costly.

84. **The macroeconomic environment is currently unfavorable for the banking industry**. Though GDP growth has been generally high, the fiscal position has deteriorated substantially and the government continues to incur domestic arrears that have underpinned the high NPLs across the industry. More recently, although the BOG has been reducing the policy rate and inflation has fallen to single digits, lending rates have been slow to respond largely due to: (i) high inflation expectations in the face of weak fiscal fundamentals; (ii) rigidities in the banks' balance sheets; (iii) high operating cost; (iv) high reserve requirements; and (v) high NPLs and associated provisions.

85. **The legislative and institutional framework for insolvency and creditor rights has been undergoing reforms, but important weaknesses persist.** The legal framework for insolvency is outdated and out of step with the realities of modern commerce. Further, despite the establishment of commercial courts, the procedures for taking and enforcing security are time-consuming, legally complex, costly, and unpredictable. The establishment of the new Collateral Registry offers the advantage of non-judicial enforcement of the charges, but registration is additional to registration in the other relevant registries. There appears to be little coordination between the various registries, confusion regarding the order in which registration must be carried out, and which registrations establish unimpeachable title to security.

86. **The accomplishments in strengthening accounting and auditing standards need to be complimented by actual implementation.** The law requires banks to present accounts in accordance with the IFRS. However, the financial statement of some banks and other financial institutions were found to be non-compliant with some of the requirements of the IFRS. In some cases, inappropriate accounting techniques have been used to camouflage losses and demonstrate healthy balance sheets. The weaknesses are attributable to the absence of an appropriate enforcement mechanism to ensure compliance with the IFRS and the absence of an independent oversight of the profession.

87. **The payment system has been significantly improved but there is scope for improvement.** Further work is needed to improve the oversight of the payment system; address gaps in processes that introduce settlement risk; improve business continuity arrangements and the ensure interoperability of systems.

88. **Recent reforms have equipped the country with a regime for AML/CFT, but a number of legislative and regulatory improvements are still needed.** Ghana is not yet compliant with most core and key FATF recommendations. The Financial Intelligence Centre (FIC) had since been established but the very high volume of cross-border cash movement calls for greater vigilance in supervision of AML/CFT.

89. **Market discipline is ineffective due to structural and public infrastructure constraints and cannot be expected to influence the amount of capital a bank holds**. There are currently no rating agencies, financial journalism is not well developed, and there is a paucity of market analysts. Only six of the 26 banks are listed in the GSE and almost all banks,

except one that has issued a bond, rely almost exclusively on deposits and direct borrowing for funding.

90. **There are also some gaps in the mechanisms for providing an appropriate level of systemic protection (or public safety net).** Ghana has no explicit deposit protection scheme and a documented contingency plan for dealing with system-wide bank failures. The BOG could also benefit from additional resolution powers that allow the BOG to intervene without recourse to shareholders or the courts, while preserving shareholders rights.

Principle-by-Principle Assessment

91. **The BOG has been making efforts to align its regulatory and supervisory framework with international standards, but important gaps remain.** Despite major accomplishments on the legislative front and efforts to strengthen the supervisory process, 14 of the 25 Basel Core Principles supervisory practices were found to be either non-compliant or materially non-compliant. Some of the shortcomings have important implications for banking system soundness, most notably consolidated supervision, lack of supervisory guidelines on risk management, and supervisory forbearance. Other notable areas where compliance is significantly deficient relate to the licensing process and ineffective enforcement of the AML/CFT guidelines. The assessments are summarized below.

Objectives, independence, powers, transparency, and cooperation (CP 1)

92. **The BOG's responsibilities and supervisory objectives are well entrenched in law and clear.** Since the last FSAP in 2003, several legislative improvements have been made in establishing the BOG's primary objectives, operational autonomy, transparency and accountability. In addition, the law significantly enhanced the BOG's powers to take proactive remedial actions and resolve problem banks.

93. **However, the BOG has not always been as forceful and proactive in utilizing its legal powers, particularly in the cases of SBs.** There are instances where banks that did not meet the minimum solvency and other prudential requirements were permitted to continue undertaking normal banking business in contravention of the banking laws. The BOG used a temporary liquidity facility to keep afloat a bank that would otherwise have been insolvent. Also, ownership stake in some banks by the BOG, complicates supervisory governance and could taint its reputation and credibility where enforcement actions are delayed, or in the event banks in which either the government or BOG has beneficial ownership become a source of systemic banking problems.

94. **The BOG had started informal discussions with both the NIC and the SEC to enter into a joint MOU that would facilitate the sharing and exchange of information among all domestic regulatory bodies.** MOUs have also been executed between the BOG and some but not all foreign supervisors, and there is significant room for improvement in terms of practical implementation.

Licensing and structure (CPs 2–5)

95. **The BOG is the sole licensing authority for banks and other NBFIs falling under its regulatory and supervisory purview.** However, the opportunity for the applicants to appeal a licensing decision or an order by the BOG to the minister, to be advised by a three-man panel on which the BOG has one representative, could jeopardize the operational autonomy. In licensing subsidiaries of foreign banks, the BOG does not conduct a detailed due diligence exercise on the parent bank and/or home supervisory authority.

Prudential regulation and requirements (CPs 6–18)

96. **The prudential requirements are set out in the banking law and BOG has power to issue supervisory directives and other administrative guidelines.** In 2008, the BOG issued a directive to increase the minimum capital requirement for banks to be ₵60 million by December 31, 2009 for foreign-owned banks and December 2012 for domestic banks. Banks are permitted to trade for their own account in foreign currency subject to observing open position limit of 15 percent for a single currency exposure and, in aggregate, 30 percent of the bank's regulatory capital.

97. **However, the BOG is short of formal minimum risk management guidelines covering all risk categories and aspects.**[29] It relies on "good practice" guidelines that lack the detail and rigor to serve as the minimum regulatory benchmark for a supervisory authority and do not address jurisdiction specific risks. Furthermore, international "good practice" does not distinguish between essential prerequisites and "nice to have" practices. The lack of a clear minimum supervisory standard can lead to inconsistencies in implementation of regulations.

98. **Many Ghanaian banks do not have comprehensive and robust risk management infrastructure, including internal risk rating systems, risk quantification and structured risk reporting, as well as rigorous qualifying standards for internal assessments of risk as inputs to the calculation of the amount of economic capital.** Except for a few subsidiaries of major internationally-active banks, the risk management culture was not embedded in the investment/trading, banking and other operational processes of banks and, in particular, a majority of banks neither had a forward-looking approach to capital management nor any internal process for assessing overall capital adequacy in relation to their risk profile.

Methods of ongoing banking supervision (CPs 19–21)

99. **The BOG has adopted a risk-based approach and techniques for bank supervision, but more work is needed to achieve the objectives.** Key challenges include the lack of human capacity, including expert risk analysts and systems, as well as more comprehensive risk-based

[29] There are no guidelines for credit risk, market risk, operational risk nor are there minimum guidelines covering risk management and governance, internal control, compliance, and internal audit.

senior management reporting and the setting of risk based capital requirements and on site schedules.

100. **The BOG needs to establish a clear project implementation plan for an effective and comprehensive risk-based supervisory framework.** The plan should address greater investment in systems and data processing capability, the hiring of specialized risk experts, particularly in areas such as IT and market risk as well as the development of supervisory guidelines on minimum standards for credit, market, liquidity, and operational risk management and corporate governance framework for banks.

Accounting and disclosure (CP 22)

101. **Accounting and auditing requirements are generally in line with the IFRS and International Standards on Accounting (ISA) but in some instances, practices have fallen short.** Banks are required to publish audited financial statements annually. External auditors are required to issue a "long form" report to the BOG after conclusion of the statutory audit of the bank. Furthermore, the BOG has the power to object to the appointment of an external auditor.

102. **However, financial statements of some banks were found to be non compliant with the requirements of the IFRS**. Also, communication between the external auditors and BOG could be enhanced further by more frequent bilateral meetings, at least once a year, to share information on emerging risks and other pertinent issues relating to safety and soundness of a bank's operations. Auditors appeared to be under pressure to further reduce fees and hence the time spent on their banking mandates to remain competitive and there are also capacity concerns with external auditors.

103. **The BOG should ensure that bank audits remain of a high standard.** In the short term, it can do so by meeting and challenging external auditors more frequently as indicated above, but also by requiring the reporting of actual and budgeted time spent on the mandate and meeting banks that put too much emphasis on audit fees instead of audit quality. In the longer term, legal powers to review working papers should also be sought.

Corrective and remedial powers of supervisors (CP 23)

104. **Section 60 (b) of the Banking (Amendment) Act, in particular, has provided the BOG with a range of remedial powers, including appointment of an advisor and conservator.** These powers include the ability to prohibit a bank from taking deposits, lending and/or paying dividends when not meeting prudential norms or it is conducting its business in an unsafe and unsound manner. The BOG is also empowered to remove management or board of directors of a bank. Also, section 26 of the Banking Act gives the BOG unfettered powers to arrange the merger of a troubled bank with a healthy one or such other action as the BOG deems appropriate in the event of a persistent problem of capital deficiency.

105. **However, the BOG could benefit from additional remedial powers and there is need to improve enforcement of the powers.** In particular, the remedial powers in section 60 (b) could be expanded as detailed in Appendix I. Further, the BOG has been slow and shown

lack of firmness in taking prompt and effective remedial actions, particularly with respect to banks in which either government or the BOG has a shareholding. This could compromise the integrity and reputation of the BOG. There is also a need for more explicit arrangements for handling a system-wide banking crisis, including a formal financial sector contingency plan to, *inter alia*, address a systemic banking crisis. The blanket provision given by the "catch all" phrase exposes the BOG to potential legal challenges from shareholders of the bank and can lead to inconsistencies in interpretation and implementation by supervisors. Thus it is important to enumerate the powers that the BOG has and the conditions under which the powers can be used. The BOG also needs additional resolution options such as the ability to intervene insolvent banks without consent of court and current shareholders, including purchase and assumption subject to adequate provisions for the protection of shareholders. The provision that the BOG intervenes only when all capital is exhausted is too low and a higher threshold of say 4 percent could be considered to trigger corrective action.

Consolidated and cross-border banking supervision (CPs 24–25)

106. **The BOG does not have powers to undertake consolidated supervision despite the predominance of foreign-owned banks and the growing importance of conglomerates.** The BOG cooperates closely on an informal basis with the Central Bank of Nigeria, but there is a need to formalize the arrangement and to extend the cooperation to supervisors of the other banks. Also, a more interactive engagement with other domestic supervisory authorities, notably The NIC, SEC and NPRA, with a view of harmonizing common prudential norms, such as the fit and proper criteria for the management and board members, should be considered.

Appendix Table 5. Action Plan to Improve Compliance of the Basel Core Principles

Reference Principle	Recommended Action
CP1 Objectives, Autonomy, Powers and Resources	The BOG General Conditions of Service should prohibit any staff member to be appointed to the Board of a supervised financial institution or own significant shareholding in banks. The BOG should establish a program to divest any direct or direct shareholding in banks.
CP3 Licensing Criteria	Amend the Banking Act, so that the minister is removed from the licensing process and ensure that licensing of banks is the exclusive right of the central bank.
CP4 Transfer of significant ownership	The BOG should require all listed banks to report significant changes in ownership immediately on such occurrence and, at regular intervals, including the identity of the beneficial owners.
CP6 Capital Adequacy	No bank should be permitted to take deposits while its regulatory capital adequacy ratio is less than the minimum requirement of 10 percent. The scope and timing of the proposed Basel II implementation should be further reviewed to allow for more consultations and preparations.
CP 7. Risk Management Process	Develop supervisory guidance or examination manuals for supervisors.

Reference Principle	Recommended Action
CP 8 Credit Risk	Issue guidelines on the qualitative aspects of credit risk management before moving to Basel II.
CP 9 Problem assets, Provisions and reserves	Issue guidelines on risk management in the area of problem assets, provisions and reserves.
CP 10. Other risks	Develop guidelines requiring banks to put in place policies and processes for the management of concentration, country, market, and operational risks and include these risks in the scope of onsite examinations.
CP 11. Exposures to related parties	Issue formal requirements for banks to have documented policies and procedures to prevent persons making credit decisions or granting loans benefitting from the proceeds of the loan.
CP 14-16 Liquidity risk and interest risk	Develop procedures to require stress testing and scenario analysis for liquidity and interest risk management.
CP 17 Internal control and audit	Issue formal guidelines detailing minimum requirements for internal controls for banks.
CP 18 Abuse of financial services	Accelerate the promulgation of the laws and regulations, currently in draft, to allow the FIC to start performing its statutory functions as enshrined in the Anti-Money Laundering Act of 2008.
CP 22 Accounting and disclosure	Meet and challenge external auditors more frequently. Obtain the power to assess external auditors working papers and Issue public disclosure requirements.
CP 23 Corrective and remedial powers	Streamline decision making for taking prompt remedial measures. The temporary liquidity support facility should not be used to recapitalize banks. Expand BOG's resolution powers.
CP 24 Consolidated supervision	Adopt action plan to regulate and supervise groups where bank is a material entity or the parent of a corporate group.
CP 25 Home-host relationships	Continue to formalize all information-sharing arrangements with home supervisory authorities of foreign subsidiaries with a presence in Ghana.

Authorities' response

The authorities had an opportunity to review and discuss the BCP assessment report with the FSAP assessors. They broadly agreed with the assessment and certain clarifications of facts were provided which were accepted. The Ghanaian authorities have recognized the continued need to strengthen banking supervision and move towards a risk-based approach. They have also begun to address some of the shortcomings that have been identified and have requested TA to assist them with implementation.