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TECHNICAL ASSISTANCE REPORT—FINANCIAL SOUNDESS INDICATORS MISSION

This paper on Djibouti was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with Djibouti. It is based on the information available at the time it was completed on October 2018.

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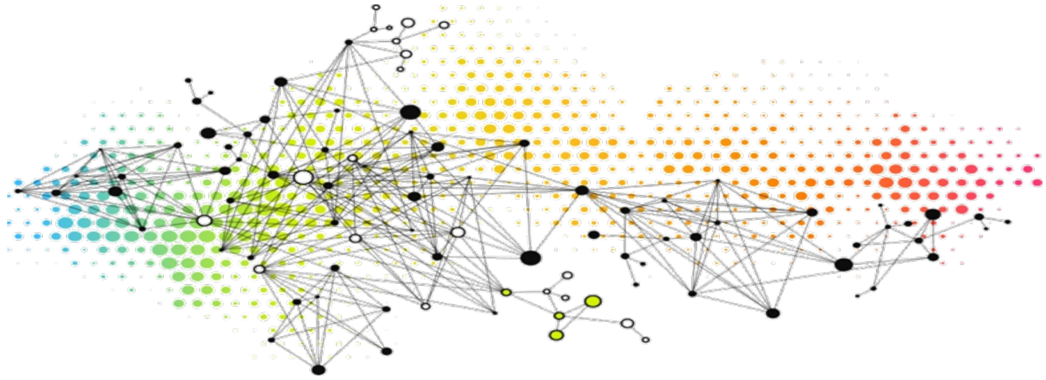

DJIBOUTI

OCTOBER 2018

TECHNICAL ASSISTANCE REPORT ON THE FINANCIAL SOUNDNESS INDICATORS MISSION (MARCH 4–11, 2018)

Prepared by Samah Torchani

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Glossary

BMSU	Banks and Monetary Statistics Unit
BSU	Banking Supervision Unit
CBD	Central Bank of Djibouti
DT	Deposit taker
FSI	Financial soundness indicator
FSI Guide	*Financial Soundness Indicators Compilation Guide*
IMF	International Monetary Fund
MFI	Microfinance institution
ODC	Other depository corporation
OFC	Other financial corporation
STA	IMF's Statistics Department
TA	Technical assistance

SUMMARY OF MISSION OUTCOMES AND PRIORITY RECOMMENDATIONS

1. **In response to a request of the Central Bank of Djibouti (CBD), a mission from the International Monetary Fund's (IMF's) Statistics Department (STA) visited Djibouti during March 4-11, 2018, to provide technical assistance (TA) on the financial soundness indicators (FSIs).** The main objectives of the mission were to: (1) ensure that the source data were adequate for the compilation of the FSIs; (2) assist the CBD in the compilation of the FSIs on the basis of the international standards set out in the IMF's *Financial Soundness Indicators Compilation Guide* (*FSI Guide*); (3) guide the staff of the CBD in the preparation of the FSI metadata in line with the IMF metadata forms; and (4) agree with the Banking Supervision Unit (BSU) on an action plan for the production of the FSIs and their regular reporting to STA.

2. **The mission achieved these objectives and assisted the BSU officials in the preparation of the FSI production files (forms FS2 and FSD) and the development of the metadata files (FS1 and FSM)**. Following the mission, the FSIs were reported to STA for publication in April 2018. The mission assisted the CBD staff in the production of the FSIs and to develop 22 FSIs required in the *FSI Guide.* These 22 FSIs cover all commercial banks to include all 12 of the core FSIs and 10 additional FSIs out of the 13 that apply to commercial banks. Also, the mission provided guidance to the CBD staff in the preparation of the FSI metadata in compliance with the IMF metadata forms (FSM and FS1 forms).[1]

3. **The source data are broadly adequate for the compilation of the FSIs**. Commercial banks regularly submit financial statements containing the information needed for compilation of the FSIs to the CBD. However, the structure of the source data does not facilitate the data manipulation, mainly due to inconsistencies in the reporting by banks. These inconsistencies make the process for the aggregation of the data very time-consuming. It would be useful for the CBD to implement a tool to automate the data submission of the report forms

4. **Some discrepancies between the source data used for the FSIs and monetary and financial statistics were identified**. For consistency purpose, the mission reviewed the aggregated balance sheets used to compile the FSIs and the monetary and financial statistics based on the standardized report forms (SRF 2SR), it appeared that there are discrepancies between the two source data. As the consolidation basis used for the compilation of the FSIs is "domestic consolidation" and given the MFS are compiled on a similar basis, the aggregated balance sheets used for compilation of the FSIs and the SRF 2SR should be identical. However, the mission noted discrepancies between the aggregated source data used in the compilation of the FSIs and the MFS. To ensure consistency between the source data from the banks' balance

[1] The FSIs are published on the IMF website: http://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA&sId=1411569045760.

sheets in the CBD, it is important that the BSU and the Banks and Monetary Statistics Unit (BMSU), which is responsible for compilation of the MFS, collaborate and share data sources.

5. **The mission held constructive discussions with the CBD staff on various other aspects of the production of statistics aimed at improving the quality of the data produced.** These discussions led to the preparation of an action plan identifying the main improvements to be pursued or undertaken, with the following priority recommendations.

Table 1. Djibouti: Priority Recommendations

Target Date	Priority Recommendation	Responsible Institutions
May 2018	*Submit completed forms FS1, FS2, FSM and FSD to STA (quarterly data 2014Q4-2017).*	**CBD (Banking Supervision Unit)**
May 2018	*Start reporting the FSIs on a quarterly basis to STA for publication on the IMF's website within 45 days following the reference quarter.*	**CBD (Banking Supervision Unit)**
December 2018	*Use the FSIs for external and internal purposes, particularly for national publication, to ensure consistency of the FSIs in all publications.*	**CBD (Banking Supervision Unit)**

6. **Further details on the priority recommendations and the related actions/milestones can be found in the action plan under *Detailed Technical Assessment and Recommendations*.**

DJIBOUTI FINANCIAL SYSTEM

7. **Djibouti financial system remains dominated by the banking sector.** The banking sector dominates the financial sector in Djibouti, representing 94 percent of the total assets of the financial system and holding 80 percent of total loans to the economy. At end-2017, Djibouti banking system comprised 12 active commercial banks (one domestically-controlled and 11 foreign-controlled) and two commercial banks under liquidation.[2] The foreign-controlled banks include two Islamic banks.

8. **The other financial corporations (OFC) sector is not yet very developed and all financial institutions are under the supervision of the CBD except for insurance companies and pension funds.** The non-bank financial corporations sector consists of three microfinance

[2] In the *FSI Guide*, it is recommended that financial institutions in distress that otherwise meet the definition of a deposit taker continue to be included in the deposit-taking reporting population for calculating FSIs. Their assets and liabilities exist in the deposit-taking system, and the costs of resolution may be significant. Accordingly, until a deposit taker is liquidated (that is, all assets and liabilities are written down and/or redeemed and the entity ceases to exist) or all deposit liabilities removed from its balance sheet (through either repayment or transfer to another entity), its balance sheet and income statement continue to be included in the data used for calculating FSIs for the deposit-taking sector.

institutions, one specialized credit institution, 19 exchange and money transfer bureaus and two insurance companies. There are two social security and pension funds in Djibouti (the Caisse Nationale de Sécurité Sociale and the Caisse de Retraite Militaire) as national social security entities.

9. The Islamic banks, albeit only three Islamic banks, represented 20 percent of total banking assets in 2017 rising from 1 percent in 2006. To guide the development of the Islamic banks, the CBD created a national Sharia committee to supervise the evolution of the Islamic financial instruments. The Islamic banks hold comparable shares in total assets.

10. The microfinance sector is growing in Djibouti, but access to financing remains very limited. The microfinance sector consists of three mutual or cooperative institutions all of whose deposits are collected from their members. Given that the share of microfinance institutions (MFIs) is modest (less than 1 percent of total assets and loans) and owing to time constraints the mission did not include the MFIs in the calculation of the FSIs.

11. The banking sector is growing rapidly and plays an essential role in economic growth. Its total assets more than tripled between 2006 and 2017, increasing from DF 120 million to DF 438 million. Total lending also more than tripled between 2006 and 2016, reaching DF 135 million (approximately US$3.5 million). Similarly, deposits more than doubled to DF 358 million (US$93 million).

12. The banking sector in Djibouti is subject to permanent supervision of its activities by the BSU. The BSU reviews risk quality, analyzes the financial condition of the supervised entities, and assesses the internal control arrangements. To complete the analysis of the financial condition of each institution, the BSU requested the assistance of STA in constructing the FSIs for the aggregated banking system in accordance with international principles and the methodology set out in the *FSI Guide*. These FSIs will also be used in the first-time publication of the financial stability report, covering 2017.

DETAILED TECHNICAL ASSESSMENT AND RECOMMENDATIONS

A. Compilation of Financial Soundness Indicators

13. The methodological work on the FSIs began under the auspices of the IMF in 1999 and the *FSI Guide* was published by the IMF in 2006. Forty FSIs have been defined in the *FSI Guide*, to reported to the IMF using standard report forms. The FSIs are divided into two groups: 12 core FSIs (mandatory) and 28 additional FSIs, (encouraged). The 12 core FSIs cover only financial corporations collecting deposits from the public (deposit takers—DTs). The 28 additional FSIs concern DTs (13 FSIs), OFCs (2 FSIs), nonfinancial corporations (5 FSIs), households (2 FSIs), the liquidity of the securities market (2 FSIs) and the real estate markets (4 FSIs).

14. **The FSIs are compiled on a quarterly basis and cover only commercial banks.** The balance sheets, supplementary statements and income statements of the commercial banks are transmitted to the CBD on a monthly basis while the prudential data are transmitted on a quarterly basis, and consequently the FSIs are calculated on a quarterly basis. Currently the FSIs on DTs developed by the CBD cover only commercial banks (94 percent of total assets are foreign-controlled). According to the *FSI Guide*, the DT sector consists of all financial corporations (with the exception of the central bank) that collect transferable deposits or close substitutes included in broad money. Commercial banks make up the largest proportion of DTs in all countries. Among the other financial corporations that collect deposits to be included in DTs are microfinance intuitions collecting deposits from the public that meet the definition of monetary aggregates. These categories of financial corporations must, without exception, be taken into account in the calculation of the FSIs for DTs. The mission agreed with the BSU to include MFIs in the calculation of the FSI.

15. **The consolidation basis selected is "Domestic Consolidation."** This method covers the data of resident entities and their branches and subsidiaries in the same sector that are resident in the same economy. This type of consolidation is most appropriate for Djibouti given that the banks under national and foreign control do not have foreign branches and subsidiaries.

16. **In terms of accounting concepts, the commercial banks in Djibouti follow the national accounting principles, which are based on the French chart of accounts.** Banks in Djibouti apply the accrual basis of recording, and the valuation of domestic shares and securities are based on the historical cost. Exchange rate and market price revaluation of foreign shares and securities are applied to the annual financial statement at the closing dates. While the gains are not recorded, provisions are made for unrealized losses.

17. **FS1 template (institutional coverage) was completed by the mission for 2017.** The underlying concepts (domestically-controlled versus foreign-controlled, typology of financial corporations, etc.) were discussed in detail. The CBD has all the information on financial corporations other than deposit-taking institutions (number, total balance sheet, etc.) with the exception of information on insurance companies. The BSU will organize the collection of these data once annually for purposes of form FS1. FSM-Metadata report form was completed during the mission.

B. Source Data and Report Forms

18. **Despite some deficiencies, overall the source data is adequate for FSIs compilations.** The Call Report forms used by the CBD to collect source data for the compilation of the FSIs of commercial banks are: monthly balance sheets, supplementary annexes 2 and 3 on the disaggregation of credit by sector, the monthly income statement (MOD-1080) and Annex 8 on

the prudential ratios. The bridge tables linking the source data and FS2 report form (Financial statement) for the years 2016-17 were reviewed item by item and amended, if necessary. The BSU should apply the same approach for the years 2013–17. The FSD-FSI form and the underlying series (numerators and denominators) were completed for all of the FSIs that could be produced for the commercial banks. As a result, it was possible to produce all 12 core/mandatory FSIs for the DTs and, of 10 additional/encouraged FSIs out of 13e. Of the three missing additional/encouraged FSIs, two (I016 and I017) cover transactions in derivatives and are not relevant, while the other (I021-spread between highest to lowest interbank rates) could not be calculated as there is no interbank market.

19. A review of the Call Report forms revealed a number of inconsistencies. The non-standardization of the source data call report forms renders the validation work very time-consuming. Most of the work is done manually and the source data are not presented in time series. These discrepancies will probably be resolved with the implementation of a web-based tool with the purpose of automating and harmonizing the banks' data submissions. However, until this tool is operational, the CBD must improve the existing forms by: (1) deactivating all cells that should not contain data; (2) including an automatic calculation of subtotals in the forms, not permitting manual changes; (3) developing automated validation controls to ensure consistency between the monthly statements and the sectoral breakdowns; and (4) including automatic verifications in the bank Call Report forms to alert the banks to inconsistencies before the forms are submitted.

20. *Recommended Action:* The BCD organize regular (at least annual) meetings with reporting institutions to discuss the reporting requirements and clarify them if necessary

21. The BSU staff is well qualified, despite the fact that only one official has followed the STA regional training course and is thus familiar with the IMF report forms for the calculation of the FSIs. The BSU has ten professional staff (seven auditors and three economists) who are all qualified for the compilation of the FSIs. For capacity building purposes, the mission recommended that the CBD (specifically the BSU) offered its staff regular training opportunities on the FSIs, particularly through participation in the regional courses offered by STA (which are also available in French).[3]

22. *Recommended Action:* *The BSU staff participate regularly in the FSI courses organized by the IMF*.

[3] Two staff authorities' members participated in an STA workshop on the FSIs held by the IMF and the Arab Monetary Fund in April 2018 in Dubai, United Arab Emirates.

C. Clarifications on Some Indicators

23. Clarifications were also provided on the calculation of some ratios: I001-Regulatory capital to risk-weighted assets, I004-Nonperforming loans to total gross loans, I006-Return on assets, and I014-Large exposures to capital.

Capital Adequacy

24. The *FSI Guide* recommends three indicators to measure capital adequacy (see Annex I). Two measures require the calculation of risk-weighted assets. The CBD regulations are aligned with the Basel I principles and the weights are 0, 20, 50 and 100 percent depending on the related credit risk. However, the CBD aims to adopt the Basel III principles, and against this background the minimum capital adequacy ratio required by the CBD was raised to 8 percent on December 31, 2011 and 12 percent on December 31, 2013.

Sectoral Distribution of Loans (FSI I015)

25. The core indicators measuring the quality of assets include the ratio of the sectoral distribution of loans to total loans. According to the *FSI Guide*, loans should include nonperforming loans before deduction of specific provisions. Djibouti's banking regulations do not provide a mechanism for reporting the allocation of provisions by sector by commercial banks. Given the data gaps on the sectorization of provisions, it was agreed to allocate the entire amount to the largest borrower sector, i.e., the private nonfinancial corporations' sector.

Large exposure to Capital (FSI I014)

26. The asset quality indicators to which Djibouti banks are subject include the ratio of "large exposures to capital". According to the *FSI Guide*, this ratio covers all loans included in the "large exposures" category on the basis of the directives of the national supervisory authorities, divided by total regulatory capital. In Djibouti, banks are required to ensure that the amount, for all currencies, of individual risk does not exceed a ceiling of 25 percent of capital

27. Thus, the ratio has been calculated by dividing the total "large exposures" of individual banks by their regulatory capital. The mission noted that, from one commercial bank to another, the largest exposures do not necessarily concern the same institutional units. Given that the purpose of FSI I014 is macroeconomic or sectoral in nature, covering all commercial banks, it is preferable to identify the largest borrowers from all commercial banks rather than aggregating the individual declarations of banks.

ACTION PLAN

Priority	Action/Milestone	Hypothetical Risks/ Verifiable Indicators	Target Completion Date	Actual Completion Date	Progress
Outcome 1: Source data are adequate for the production of the Monetary and Financial Statistics.					
H	The source data are adequate for the production of the FSIs for DTs.	1/ To ensure data consistency and reliability, use automatic verification and validation mechanisms on the report forms.	End-December 2018		
		2/ Clearly communicate the definition of the account headings to the banks.	End-December 2018		
Outcome 2: A new database is compiled for internal/external publication.					
H	FSIs for DTs in compliance with the *Monetary and Financial Statistics Manual* are available.	Transmission to STA of completed forms FS1, FS2, FSD and FSM for Djibouti (quarterly data 2012–16).	May 2018		***Completed***
Outcome 3: Human resources are adequate for the compilation and dissemination of the monetary and financial statistics.					
H	Train additional officials in the FSIs.	The CBD agent contributes efficiently to the production of the FSIs	December 2018		***Completed***

Annex I. List of Financial Soundness Indicators

A - Core Indicators (mandatory) (12 FSIs)

DT00	**Core FSIs for Deposit Takers (12 FSIs)**
I001	Regulatory capital to risk-weighted assets
I002	Regulatory Tier 1 capital to risk-weighted assets
I003	Nonperforming loans net of provisions to capital
I004	Nonperforming loans to total gross loans
I005	Sectoral distribution of loans to total loans
I006	Return on assets
I007	Return on equity
I008	Interest margin to gross income
I009	Noninterest expenses to gross income
I010	Liquid assets to total assets (liquid asset ratio)
I011	Liquid assets to short-term liabilities
I012	Net open position in foreign exchange to capital

B – Additional Indicators (encouraged) (28 FSIs)

DT00	**Additional FSIs for Deposit Takers (13 FSIs)**
I013	Capital to assets
I014	Large exposures to capital
I015	Geographic distribution of loans to total loans
I016	Gross asset position in financial derivatives to capital
I017	Gross liability position in financial derivatives to capital
I018	Trading income to total income
I019	Personnel expenses to noninterest expenses
I020	Spread between reference lending and deposit rates (basis points)
I021	Spread between highest to lowest interbank rates (basis points)
I022	Customer deposits to total (non-interbank) loans
I023	Foreign-currency-denominated loans to total loans
I024	Foreign-currency-denominated liabilities to total liabilities
I025	Net open position in equities to capital

OF00	**Other Financial Corporations (OFC) (2 FSIs)**
I026	Assets to total financial system assets
I027	Assets to gross domestic product (GDP)
NF00	**Nonfinancial corporations (5 FSIs)**
I028	Total debt to equity
I029	Return on equity
I030	Earnings to interest and principal expenses
I031	Net foreign exchange exposure to equity
I032	Number of bankruptcy proceedings initiated / Number of applications for protection from creditors
HH00	**Households (2 FSIs)**
I033	Household debt to gross domestic product (GDP)
I034	Household debt service and principal payments to income
ML00	**Market Liquidity (2 FSIs)**
I035	Average bid-ask spread in the securities market
I036	Average daily turnover ratio in the securities market
RE00	**Real Estate Markets (4 FSIs)**
I037	Residential real estate prices (Percentage change/last 12 months)
I038	Commercial real estate prices (Percentage change/last 12 months)
I039	Residential real estate loans to total gross loans
I040	Commercial real estate loans to total gross loans

Annex II. List of Officials Met During the Mission

Name	INSTITUTION
Mr. Ahmed Osman	Governor of the Central Bank of Djibouti
Mr. Malik Garad	Chief of the Banking Supervision Unit
Mr. Omar Ibrahim	Banking Supervision Inspector
Mrs. Naima Abdi	Banking Supervision Inspector
Mr. Kadra Idriss	Banking Supervision Inspector
Mr. Doualeh Djama	Banking Supervision Inspector
Mr. Kadar Daoud	Banking Supervision Inspector
Mrs. Fathia Mohamed	Banking Supervision Inspector
Mr. Abdirahman Robleh	Chief of the Banks and Monetary Statistics Unit