



MOROCCO

SELECTED ISSUES

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Approved By
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Central Asia
Department

Prepared By Pilar Garcia Martinez

CONTENTS

THE SUB-SAHARAN EXPANSION OF MOROCCAN BANKS: CHALLENGES AND OPPORTUNITIES _____ 2

A. Overview of the Moroccan Banking Sector _____ 2

B. The Systemic Presence of the Moroccan Banks in SSA _____ 3

C. Drivers of the Expansion and the Role of BAM _____ 5

D. Opportunities, Challenges, and New Spillover Channels _____ 8

E. The Cross-Border Expansion in SSA Poses Supervisory Challenges _____ 11

F. Policy Recommendations _____ 12

References _____ 15

FIGURES

1. Concentration of Deposit and Credit of the Three and Five Largest Moroccan Banks __ 2

2. Systemic Presence of Moroccan Banks per Country (Percent) _____ 4

3. SSA Expansion of the Three Largest Moroccan banks _____ 5

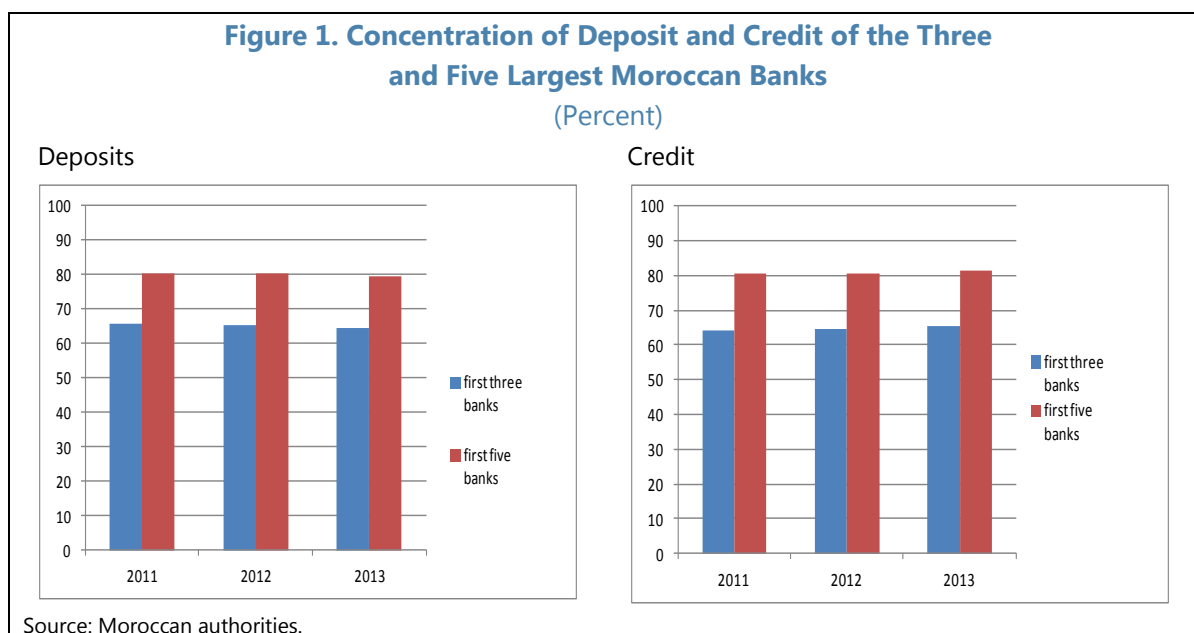
4. Exports from Morocco to Selected Economic Regions, 2008–13 _____ 6

THE SUB-SAHARAN EXPANSION OF MOROCCAN BANKS: CHALLENGES AND OPPORTUNITIES

This paper presents an overview of the cross-border expansion of Moroccan banks in sub-Saharan Africa (SSA) and discusses policies to minimize possible negative spillovers and address the main supervisory challenges. It builds on the analysis and main results of a Pan-African Cross-Border Exercise (PACBE), a joint initiative by the IMF's African (AFR) and Monetary and Capital Markets (MCM) departments, with the collaboration of the Middle East and Central Asia department (MCD). The PACBE assesses the implications of the rapid development of Pan-African banking groups, including the challenges they pose for supervision and financial stability in the region. The analysis is based on publicly available data and was informed by discussions during missions to Morocco and selected West African countries, and by a high-level seminar during the 2014 Annual Meetings.

A. Overview of the Moroccan Banking Sector

1. The Moroccan banking sector is relatively large and well-developed. The banking system is at the core of the financial sector, with bank assets equivalent to 126 percent of GDP in 2013 (81 percent in 2004). It comprises 19 banks, of which five are majority public-owned and seven majority foreign-owned. The sector is dominated by the five largest banks, which hold a market share of deposits and credit of about 80 percent (Figure 1). The three largest banks, Attijariwafa, Banque Marocaine du Commerce Extérieur (BMCE) and Banque Centrale Populaire (BCP), hold about two-thirds of total bank assets.



2. The sector remains sound overall. Aggregated data indicate that the banking sector as a whole is well capitalized. In June 2014, the average capital adequacy ratio was 13.5, well above the minimum requirement. Deposits are the main funding source for banks, amounting to two-thirds of their liabilities on average in 2013. Banks' liquidity has been relatively tight prompting BAM to fill the gap, which it did mainly through seven-day advances. Cash advances provided by BAM reached about 7 percent of total bank liabilities in 2013. Nonperforming loans (NPLs) remain relatively moderate but have increased recently, reflecting the economic slowdown, reaching 6.9 percent in October 2014. FX exposure remains relatively small. Domestic private credit is mainly provided in dirham; only about 3 percent of total domestic credit is in FX. An updated financial sector assessment program (FSAP) planned for the first half of 2015 will provide a more detailed assessment.

3. The international activity of the three largest banks is estimated at about one fifth of the total consolidated assets. In the past decade, the three largest Moroccan banks have expanded their operations internationally. At the end of 2013, they were present in 10 European and 22 African countries, including member countries of the West African Economic and Monetary Union (WAEMU) and the Central African Economic and Monetary Union (CEMAC), Tunisia, Mauritania, and some Anglophone African countries, with a total of 40 subsidiaries and 14 branches. The international activity of the Moroccan banks constituted about 19 percent of total volume of activity of the sector (17 percent for activity in Africa, and about 2 percent for activity in Europe.) This international activity was the origin of 21 percent of total deposits, 16 percent of the credit, and 21 percent of revenues on a consolidated basis.

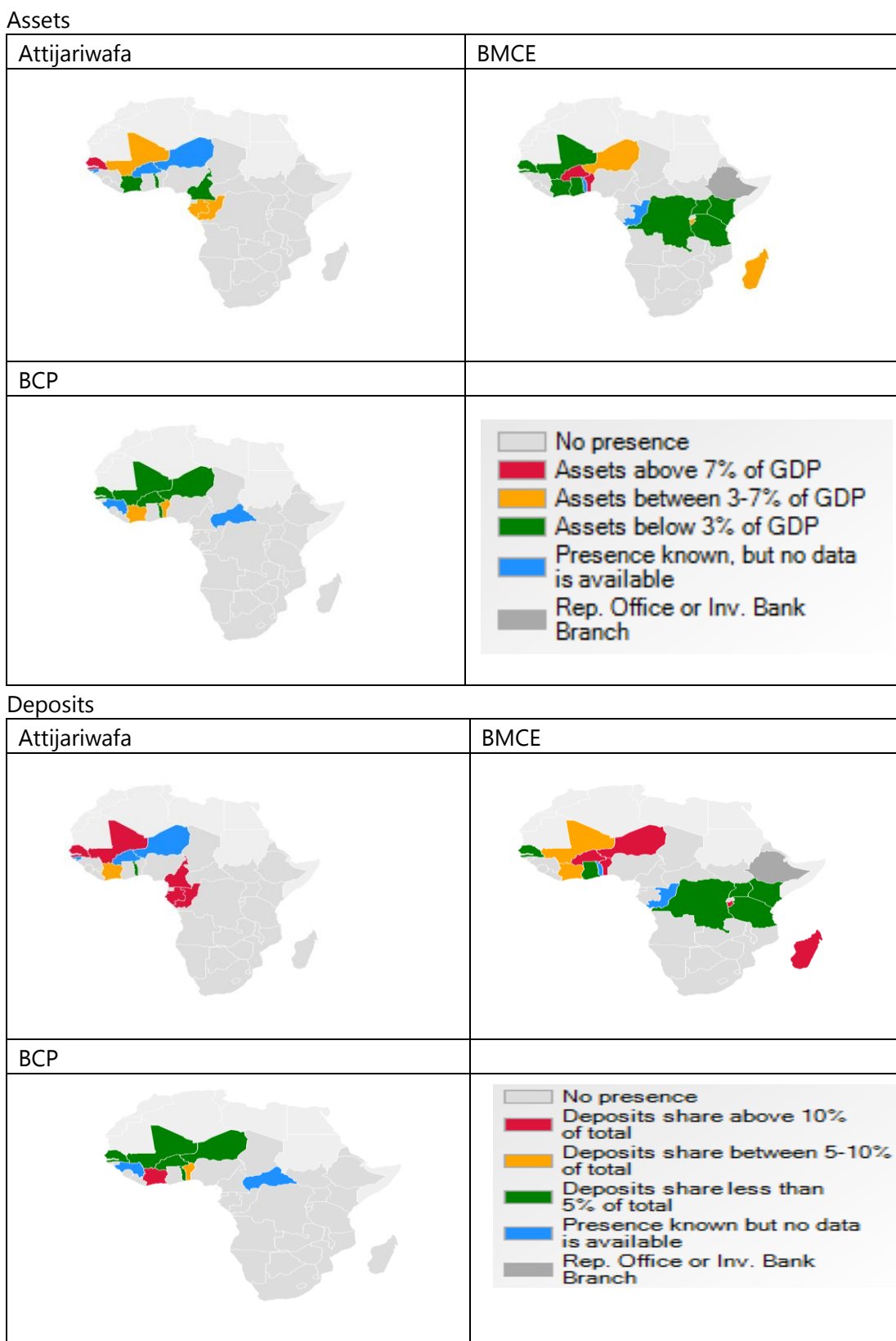
B. The Systemic Presence of the Moroccan Banks in SSA

4. Cross-border operations of the three largest banks are an important part of the consolidated balance sheet of the groups, with some subsidiaries being systemic in their host countries.¹ The share of the SSA assets in the total consolidated assets within the groups is significant in some cases (9 percent for BCP, 20 percent for Attijariwafa, and 24 percent for BMCE, in 2013). Nevertheless, the three Pan-African Moroccan banks have a systemic presence in several SSA countries (Benin, Burkina Faso, Cameroon, Congo, Djibouti, Gabon, Ivory Coast, Madagascar, Mali, Niger, and Senegal) (Figure 2).

5. The limited available financial soundness indicators for individual banks point to riskier and more profitable activities in some of the foreign subsidiaries. Although, the unavailability of data for the three banking groups and all their foreign subsidiaries hampered a comprehensive analysis in this study, available consolidated soundness indicators show that the groups remain sound and relatively robust. Nonetheless, some data indicate that some of the foreign subsidiaries have high profit rates but also higher levels of NPLs. For example, for some groups with publicly available data, return on assets varied between -1.6 percent and 2.7 percent across subsidiaries from different countries, while NPLs varied from 0.7 percent to 29.8 percent.

¹ A systemically important subsidiary is defined as having either a deposit share exceeding 10 percent of total deposits in the country or asset share above 7 percent of GDP per country.

Figure 2. Systemic Presence of Moroccan Banks per Country (Percent)

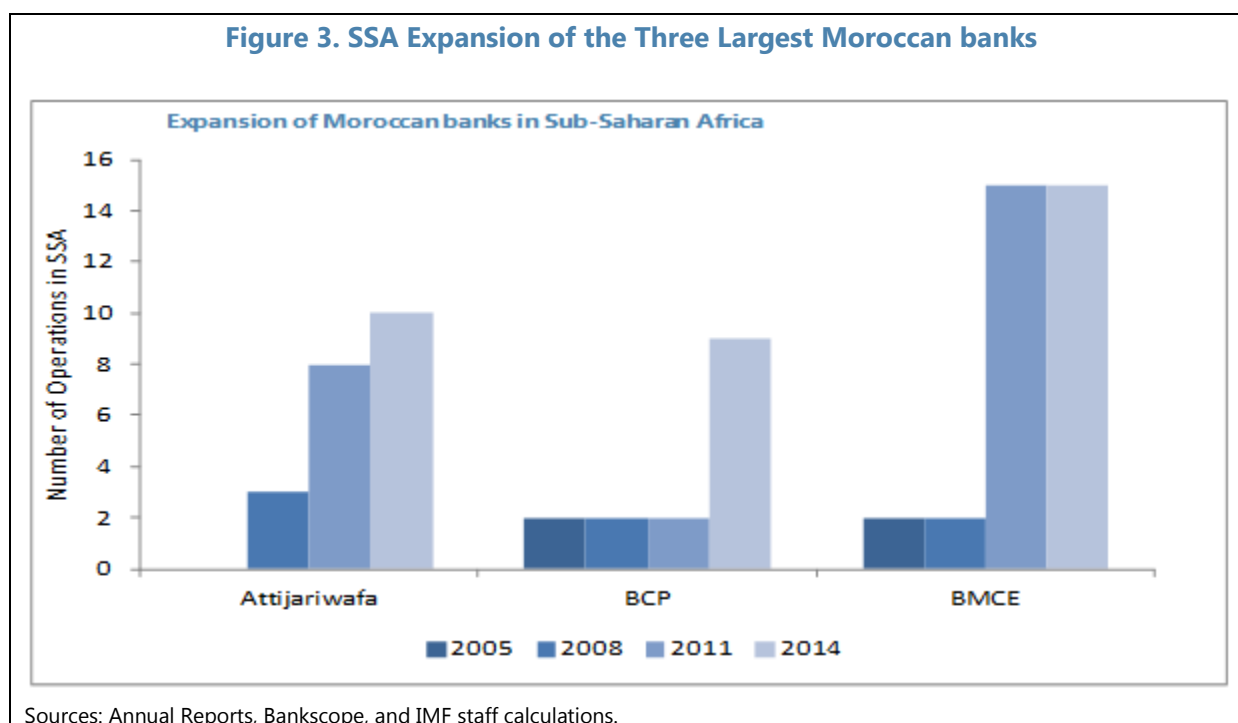


Sources: Annual Reports, Bankscope, Bankers Almanac, and IMF staff calculations.

C. Drivers of the Expansion and the Role of BAM

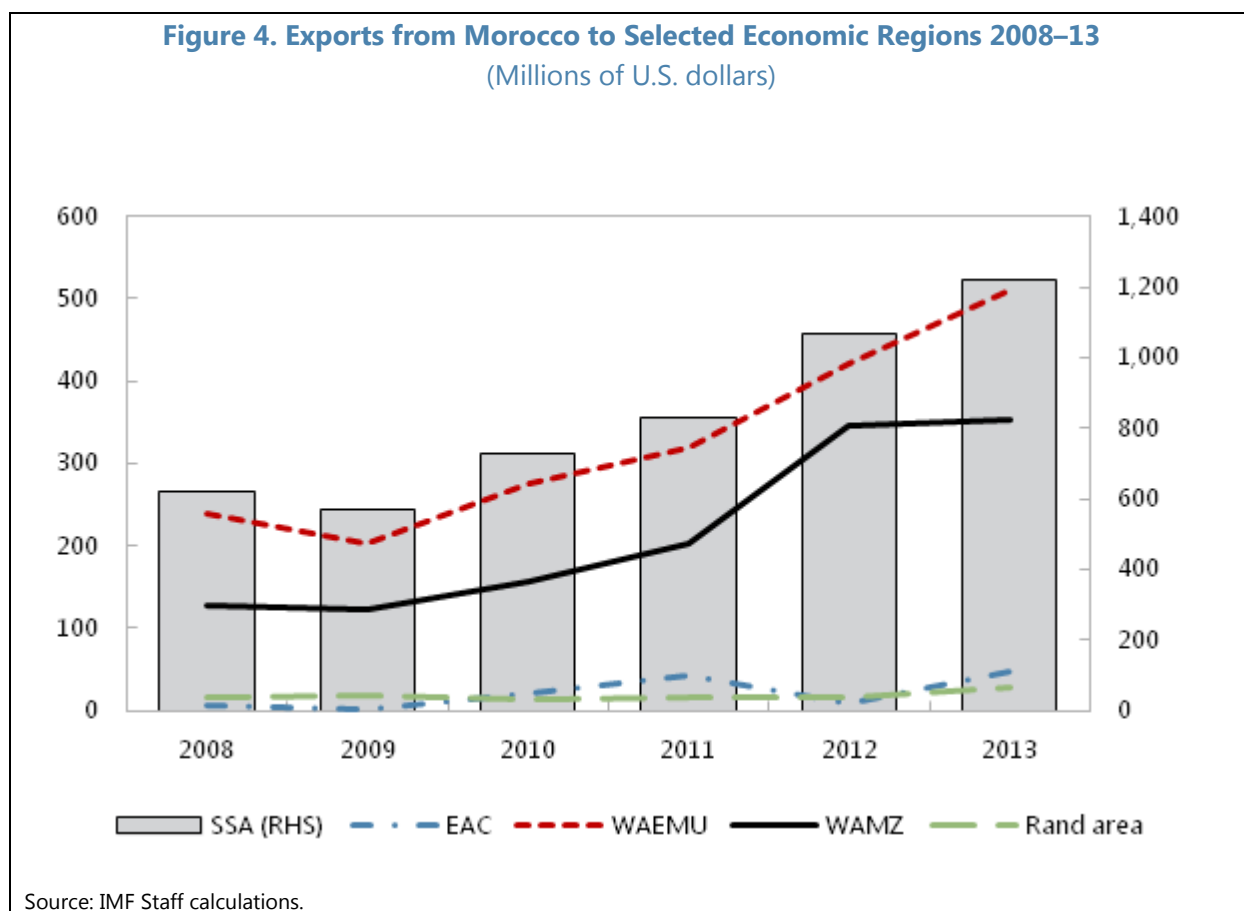
6. The three largest Moroccan banks expanded rapidly in SSA, mainly by acquiring previously existing banking groups (Figure 3). Attijariwafa expanded in 2008 by acquiring Crédit Agricole's retail banking network in five West African countries. BMCE bought a first stake in Bank of Africa (BAO) in 2008, and gradually increased its equity stake from 35 percent to 73 percent in 2014. To develop banking activities in seven countries of the WAEMU, the BCP group in 2012 signed an agreement of strategic partnership with Atlantic Financial Group (AFG) to establish Atlantic International Business. BCP now holds 50 percent of AFG and controls its management.

Figure 3. SSA Expansion of the Three Largest Moroccan banks



7. Morocco has benefitted from a privileged geostrategic position at the crossroads of Europe, Africa, and the Arab world, and from its resilience to economic slowdowns. Before 2005, Moroccan banks had only a minor presence in SSA. That presence was centered in Guinea, Mali, and the Central African Republic. After 2005, rapid expansion to new countries was driven by economic opportunities and supported by cultural links. With the economic slowdown in Morocco, the growth rate of credit to the private sector decreased from 11.2 percent in 2011 to 4.2 percent in August 2014, while the holding of public bonds increased by 70 percent over the same period. In this economic context, and with a relatively competitive and well-developed domestic financial sector, the limited domestic opportunities for rapid growth and declining profit margins led Moroccan banks to expand to SSA, where there were more opportunities for faster potential growth. The relative resilience of Moroccan banks during the global financial crisis (with banks remaining profitable and NPLs increasing only moderately) also facilitated their expansion in SSA.

8. The financial expansion of the Moroccan banks went in parallel with increasing trade flows and the expansion of Moroccan companies in SSA. Moroccan exports to SSA countries are still modest, but have increased significantly in recent years, especially to the West Africa Monetary Zone (WAMZ) and to the WAEMU (Figure 4). Exports to SSA grew more than fivefold in nominal terms over the period 2003–13, and SSA is the only region of the world with which Morocco has a trade surplus.² In addition, some Moroccan firms have established a presence in SSA (for example, in telecommunications, pharmaceutical, agro-alimentary, etc). During the period 2008–12, besides the banking sector, which attracted 54 percent of the total investment, Moroccan direct investment in SSA was heavily focused on telecommunications (34 percent of total).



² See the staff report for the 2014 Article IV consultation for further discussion on the Moroccan external sector.

9. Bank-Al-Maghrib (BAM) has played a major role guiding and supervising the expansion, aiming to make Morocco an international financial hub while ensuring appropriate risk control. BAM has been proactive in leading and supervising the expansion in three different ways:

- BAM requires prior authorization before any new international expansion can take place. Before granting an authorization, BAM analyzes the proposal based on country risk and individual banking group performance, financial soundness and governance structure.
- The three cross-border banks are requested to transmit annually to BAM the three-year business plans of their establishments abroad, laying out the expected evolution of their activity and, particularly, the expected evolution of credits, deposits, network of agencies, and results.
- BAM sponsored the signature of a code of conduct by the three banks that operate in SSA. It set up an African Committee in which the three banks meet with BAM to monitor the honoring of the code of conduct, discuss their plans, and share information. This Committee meets twice a year at the highest level and undertakes quarterly meetings at the technical level.

10. Although not a formal precondition, bilateral Memoranda of Understanding (MOU) have been signed with most of the host countries in which Moroccan banks are present. MOUs contain provisions on prudential supervision, sharing of information, conduct of inspections, and training and capacity-building. However, the MOUs have not included provisions on banking resolution—an area that calls for improvement and which will require the involvement of the Ministers of Finance.

11. The pace of expansion is expected to slow considerably in the near term. Rather than an expansion with a small presence in a larger number of countries, BAM has been encouraging Moroccan banks to take majority stakes in foreign banks, which would give them more control over the subsidiaries and their management. In this respect, BAM's preference at this stage is that the Moroccan cross-border groups consolidate their current presence in the countries (for example, integrate their accounting standards and their IT systems) rather than expanding further. The cross-border groups have also indicated that they are not considering further significant expansion in the near future.

12. BAM is implementing and further strengthening its supervisory standards. BAM undertakes consolidated supervision of banking groups and requests banks to comply with prudential standards that are already higher than the ones applied by host countries. It already organized a first meeting of the supervisory college of one of the largest banks, and it expects to organize similar meetings for the other two large banks in the first quarter of 2015. BAM holds regular conference calls with other supervisors and conducts joint inspections of subsidiaries. Morocco is in the process of revising its central bank law; in November 2014 the Parliament approved a new banking law which is expected to strengthen BAM's supervision powers (for

example, allowing the rejection of acquisitions when they may pose challenges to the stability of the group, even when the potential acquisition is within the thresholds established by the law).

13. In addition, the recently approved new banking law establishes the possibility of special measures for domestic systemic institutions, including special resolution plans. The new banking law authorizes the governor of the central bank to impose prudential measures for those banks considered as systemic domestically. In addition, it provides the governor with the power to set up an urgency mechanism to resolve banking crises through the establishment of a provisional administrator and the transfer of nonperforming assets to an ad hoc structure, or through a possible split.

D. Opportunities, Challenges, and New Spillover Channels

14. The expansion of the Moroccan banks across SSA offers opportunities and benefits for Morocco as well as for the host countries.

- For Morocco, the presence of Moroccan banks in SSA countries brings new business opportunities (about 21 percent of the revenue of the banking sector is coming from cross-border activities) and helps promote greater diversification of risk for the financial sector, fostering economies of scale and better allocation of resources.
- For the host countries, cross-border banks can bring benefits in three areas.³
 - *Competition, efficiency, and innovation.* The presence of cross-border foreign banks may increase competition, access to higher skills and expertise, and access to capital. Moreover, these banks can have a positive effect by fostering improvements in the governance structures in the host markets. However, whether they have an overall positive effect will depend on the extent to which they contribute to crowding the host market.
 - *Financial deepening and inclusion.* Cross-border banks may help promote financial inclusion if they reach previously underserved segments of the market and do not only concentrate on top-end customers or governments. However, although total lending may increase with the presence of cross-border banks, this effect is not guaranteed, because these banks will face the same issues that beset those already present and typically hamper financial sector development: lack of collateral, unreliable accounting information, or insufficiently transparent market. In practice, outcomes are very context-specific, and the lack of data and rigorous studies does not allow providing an assessment of the impact of Moroccan banks on financial inclusion in Africa.

³ See Beck and others, 2014, "Making Cross-Border Banking Work for Africa."

- *Financial stability.* Cross-border banks can positively contribute to financial stability through diversification of sources of financing. Some indirect financial stability benefits can stem from upgrades in the quality of supervision and regulation induced by foreign banks if they introduce higher standards based on their home supervision (for example, international financial reporting standards (IFRS) accounting and Basel II/III standards). However, this requires the implementation of high consolidated supervisory standards by home supervisors and strong cooperation among home and host supervisors.

15. The rise of Pan-African banks also opens new channels for transmission of macro-financial risks and other spillovers across home and host countries. Together with the benefits, cross-border banking may also bring new channels through which the contagion of negative shocks can be transmitted.⁴ Unfortunately, data on interconnections within cross-border banks are not systematically available, and therefore these risks could build up undetected. Possible negative spillovers could include the following:

- Interactions between the real and the financial sector could be amplified by the presence of systemic interconnected cross-border financial institutions. During an upturn, as leverage and competition among financial institutions increases, bank portfolios can become highly exposed to particular types of assets (such as real estate), and banks can become more vulnerable by exposure to balance sheet weakness or mismatches in areas such as liquidity, maturity, and foreign exchange.⁵ Vulnerabilities would emerge and be transmitted in a downturn shock because collateral values may decline, capital may be insufficient to absorb losses, credit is reduced, and depositors' confidence may be affected, which could have an impact on bank liquidity.
- A liquidity or solvency problem in a foreign subsidiary could pass on to another subsidiary in a different country or in the home country. One channel through which such financial contagion could be transmitted is the presence of a "common lender" that may be the main funding source for a number of countries. If the common lender is "contaminated" the liquidity or solvency problem could be expanded to other countries.
- Similarly, a sudden reassessment of a parent bank's exposure to a particular subsidiary or a country, or a need for recapitalization or reallocation of the parent bank's capital could trigger liquidity or solvency pressures in a subsidiary in another country.
- Some banks are connected through syndicated loans across borders, which can lead to potential spillovers between subsidiaries. Information on the amounts of these loans is not available.

⁴ See, for instance, Árvai, Zsófia, Driessen, Karl, and Ötker-Robe, Inci, 2009, Regional Financial Interlinkages and Financial Contagion within Europe.

⁵ See O. Canuto and S. Ghosh, 2013, Dealing with the Challenges of Macro Financial Linkages in Emerging Markets.

- Reputational problems, including potential macroeconomic and financial vulnerabilities in the home or host country, or deficiencies in governance or perceptions of mismanagement within the banking groups, could be transmitted between the home and the host countries, potentially increasing operational risks and the cost of funding, or making it more difficult to capture deposits.

16. Possible risks from cross-border banking may be mitigated or exacerbated by different financial market structures and business models. Three main factors may influence the magnitude and form of possible financial contagion:

- The international groups' banking model: subsidiaries vs. branches. There is no one-size-fits-all approach, and the appropriateness of a standalone subsidiaries model versus a more integrated one will depend on different circumstances. Home authorities would prefer the establishment of standalone subsidiaries with stricter firewalls (in most cases, the Morocco model) when their banks expand into countries with economies perceived to be weaker and where the business environment is more risky, even if this choice involves relatively higher set-up fixed costs. Host authorities might also prefer the subsidiary model if conditions in their country are better than those in the home country, to shield the local subsidiaries from the problems of the parent. By contrast, countries with underdeveloped financial systems and weak economies may prefer global banks to enter via branches that can facilitate credit services based on the parent's strength, especially when the quality of supervision is higher in the home country and information-sharing mechanisms between home and host countries are not properly developed.
- The banks' funding structure. A banking funding structure that mainly relies on an ample retail deposit base (as in the case of Morocco) is likely to be more resilient. In banking systems that depend heavily on wholesale funding and funding structures where interbank market linkages are substantial, liquidity problems can more easily spread to other domestic or foreign-owned banks.
- Financial market structure: The financial market structure of the host country and the degree of financial intermediation is instrumental in allowing proper diversification and risks coverage. However, complex structures and products may entail their own financial stability risks which could be propagated to other countries.

17. The vulnerability of a banking system will also depend on institutional soundness and macroeconomic fundamentals. Sustained financial system health depends, in large part, on an adequate regulatory environment and incentive structure. A poorly regulated and supervised financial system can easily become overextended and vulnerable, especially during a period of rapid expansion. Conversely, a sound banking system that can absorb shocks (such as a sudden weakening of asset quality or a loss of deposits) helps reduce the frequency and amplitude of macroeconomic fluctuations.

E. The Cross-Border Expansion in SSA Poses Supervisory Challenges

18. The SSA expansion increases supervisory challenges. BAM implements high supervisory standards, (for example, IFRS accounting and Basel II/III standards, consolidated supervision, appropriate NPLs reporting benchmarks, threshold limiting international exposure to about 25 percent of the total assets of the banking group, etc). However, compliance with high international supervisory standards varies widely among African host countries and is generally lower than in the rest of the world. These differences in standards pose major challenges with respect to consolidated supervision, differences in accounting and data standards, and home-host coordination, among other issues.

19. The systemic importance at home and abroad of the three cross-border Moroccan banks imposes additional potential negative externalities to be taken into account by supervisors.⁶ As the Basel Committee has established, systemically important banks create negative side effects that the usual regulatory policies do not take into account. These negative externalities include the possibility of failure or impairment that can transmit shocks through the financial system and harm the real economy. Moreover, the moral hazard costs associated with direct support and implicit government guarantees may amplify risk-taking, reduce market discipline, create competitive distortions, and further increase the probability of distress—which may add to other direct high costs borne by taxpayers.

20. The increasing complexity of banking groups' corporate structures makes consolidated supervision more difficult. Many pan-African cross-border financial groups have grown increasingly complex in structures, which makes it more difficult for supervisors to form a consolidated view and assess risks. Insufficient transparency may provide opportunities for undisclosed risk transfer and obscure the true risk within the group.

21. Strong risk management frameworks are essential as cross-border activities increase operational risks. Large interconnections and competition pressures increase the pace of innovation and the complexity of the business. Ensuring the effectiveness of the risk management framework is crucial to coping with enhanced operational risks. Proper identification of risks can ensure adequate monitoring of exposures and capital positions. In addition, internal bank controls should be designed to ensure that bank activities are efficient and effective, information is reliable, timely, and complete, and that the bank is compliant with applicable law and regulations.

22. Differences in accounting and data standards complicate consolidated supervision and make comparative analysis more difficult. Morocco applies IFRS standards for financial statement reporting, but many other African jurisdictions lag behind. In particular, differences in NPL reporting

⁶ See Basel Committee on Banking Supervision, 2012, A Framework for Dealing with Domestic Systemically Important Banks.

and the appropriate provisioning may render it difficult to have an understanding of the actual situation of a particular subsidiary. Sometimes, however,, intra-group expertise can help to fill the gaps among jurisdictions.

23. BAM has well-established formal cooperation agreements with other supervisors, but there is still room for improvement. For example, some areas, such as crisis resolution, have so far remained beyond the scope of bilateral MoUs. In addition, current agreements on cooperation and exchange of information could be further strengthened.

F. Policy Recommendations

24. Given the importance of the cross-border presence of Moroccan banks, continued close monitoring is essential. BAM should continue to ensure that the soundness of the banking sector is maintained and that banks avoid further acquisitions that might endanger their financial soundness. In addition, any further acquisition should have as a precondition the signature of a bilateral MoU to ensure adequate provision of information from the host to the home supervisory agency as to the quality of the bank that may be purchased (ex ante), as well as establish a framework for collaboration in the future.

25. Strong implementation of the new banking law and timely completion of the revision of the central bank law will be instrumental for strengthening BAM's supervisory and crisis resolution powers. These two pieces of legislation would be instrumental in this respect because they strengthen the supervisory and resolution powers of BAM: they expand its role and reinforce its instruments, and give the governor the power to resolve banking crises by setting up an urgency mechanism.

26. As Morocco faces the potential reputational risk of being home to three systemically important cross-border banks, preventive measures are needed and in the process of being implemented. In particular:

- The Basel framework for dealing with domestic systemically important banks, including higher loss absorbency capital requirements for these banks, needs to be implemented.⁷
- The funding of subsidiaries should be closely monitored. Broad reliance on local funding should be encouraged.

⁷ Basel Committee on Banking Supervision, 2013, Global Systemically Important Banks: Updated Assessment Methodology and the higher Loss Absorbency Requirement.

- Strong risk management frameworks, including among others, some internal risk limits and controls on subsidiaries that are stricter than the prudential limits set by host supervisors, especially where credit concentration regulatory limits are too high, would be helpful.

27. BAM's plan to move forward with the establishment of supervisory colleges for all three cross-border banks is welcome.⁸ The first meeting of supervisory college for one of the banks has already taken place. The setting up of supervisory college for the other two banks should move ahead as planned. These colleges should cover a broad range of issues, including anti-money laundering. The structure, discussions and organization of these colleges should be calibrated to serve as effective tools for cooperation and collaborative work among supervisors.

28. The simplification of complex corporate structures inherited from international acquisitions should be encouraged. BAM should continue to discuss with banks their plans for simplifying the integration of subsidiaries within the groups. One of the groups has already designed a medium-term plan to that effect and BAM should encourage progress in this respect.

29. Progress should continue in the implementation of a macroprudential toolkit to strengthen the surveillance of systemic risks. The extensive Fund technical assistance provided in this respect aims to support these efforts.

30. The authorities should advance the setting up of the crisis resolution mechanism provided in the new banking law.⁹ Introducing a special resolution regime (SRR) where no judge could reverse a resolution decision would allow prompt action when intervening to resolve a bank if needed. This mechanism is important for nonsystemic banks: it can help prevent a crisis by preventing contagion and deposit runs. It is even more important in systemic situations where there is a need for prompt and effective action to maintain public confidence and financial stability.

31. In addition, work on crisis preparedness and crisis management should continue. Creating a high-level crisis management committee, establishing working groups to do "what-if" simulations, and developing contingency planning manuals, with checklists and guidelines as well as developing an effective communication plan, would help in dealing with a potential crisis.¹⁰

32. Strengthening cooperation and exchange of information, including on-site visits, among African supervisors is essential for effective supervision and crisis management. The signature of MoUs is crucial. MoUs should be in place with all countries in which Moroccan banks

⁸ See Basel Committee on Banking Supervision, 2014, Principles for Effective Supervisory Colleges.

⁹ See Basel Committee on Banking Supervision, 2010, Report and Recommendations of the Cross-Border Bank Resolution Group.

¹⁰ See Basel Committee on Banking Supervision, 2011, Principles for the Sound Management of Operational Risk, Basel Committee on Banking Supervision, June.

are present. MoUs have already been signed with most of the African countries. In addition, the current coverage of the existing MoU should be extended to other areas that remain outside their scope. Agreements among supervisors should establish clear lines of responsibility and accountability, and burden-sharing plans to ensure an orderly and timely resolution framework are in place well in advance. Cooperation with other domestic supervisors, including agreements among Ministers of Finance, may facilitate the adoption of a common approach in the supervision of systemic important groups.

33. Morocco could play an instrumental role by providing technical assistance to other supervisors in the region. The SSA region may benefit from the Moroccan experience of good practices in many areas and relatively advanced supervisory capacity.

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