

West African Monetary Institute (WAMI) (Ed.)

Research Report

Financial integration in the West African Monetary Zone: A stocktake of the journey so far

WAMI Occasional Paper Series, No. 10

Provided in Cooperation with:

West African Monetary Institute (WAMI), Accra

Suggested Citation: West African Monetary Institute (WAMI) (Ed.) (2016) : Financial integration in the West African Monetary Zone: A stocktake of the journey so far, WAMI Occasional Paper Series, No. 10, West African Monetary Institute (WAMI), Accra

This Version is available at:

<https://hdl.handle.net/10419/264221>

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**WEST AFRICAN
MONETARY INSTITUTE (WAMI)**

**INSTITUT MONETAIRE DE
L'AFRIQUE DE L'OUEST (IMAO)**



**WAMI OCCASIONAL PAPER SERIES
NO. 10**

**FINANCIAL INTEGRATION IN THE WEST
AFRICAN MONETARY ZONE: A STOCKTAKE OF
THE JOURNEY SO FAR**

**ACCRA, GHANA
JUNE, 2016**

TABLE OF CONTENTS

FOREWORD	1
PREFACE	2
EXECUTIVE SUMMARY	4
1.0 INTRODUCTION	7
2.0 THE REGIONAL FINANCIAL STRUCTURE	9
2.1 Evolution of the financial sector in the WAMZ (2009-2013)	9
2.2 Financial depth and size of the banking system	15
2.2.1 <i>Financial Soundness Indicators</i>	17
2.2.2 <i>Non-bank Financial Sector in the WAMZ</i>	19
2.2.2.1 <i>Insurance Markets</i>	19
2.3 Capital Markets	21
3.0 ASSESSMENT OF CAPITAL ACCOUNT LIBERALISATION	25
3.1 The Gambia	25
3.2 Ghana	26
3.3 Guinea	27
3.4 Liberia	28
3.5 Nigeria	29
3.6 Sierra Leone	30
3.1.1 <i>Benchmarking Capital Account Openness in Member Countries of the WAMZ: A Gap Analysis</i>	31
4.0 BANKING SUPERVISION AND REGULATION	36
5.0 THE STATE OF FINANCIAL MARKETS INTEGRATION IN THE WEST AFRICAN MONETARY ZONE (WAMZ)	39
5.1 Cross-Country Pricing of Financial Assets/Interest Rate (Convergence/Divergence) .	39
5.2 Pooling of Resources in the Banking Sector	41

6.0 INSTITUTIONAL ARRANGEMENTS FOR FINANCIAL INTEGRATION IN THE WAMZ	43
6.1 Capital Markets Integration in West Africa	43
6.1.1 Why Capital Market Integration?	43
6.1.2 Roadmap of Capital Market Integration in West Africa.....	44
6.2 Banking Sector Integration in the WAMZ.....	45
6.3 Insurance Sector Integration in the WAMZ.....	46
7.0 OBSTACLES TO FINANCIAL INTEGRTAION IN THE WAMZ.....	48
7.1 Small Financial Systems Dominated by Banks	48
7.2 Low Levels of Access to Formal Financial Services	48
7.3 Limited Development of Securities Markets and Institutional Investors.....	48
7.4 Disjointed financial market regulation and supervision	48
7.5 Weak Financial Architecture for cross-border supervision of Banking Groups.....	49
7.6 High Cost of Funds.....	49
7.7 Capital Account Restrictions.....	49
7.8 Other Obstacles	49
8.0 FRAMEWORK FOR FINANCIAL INTEGRATION IN THE WAMZ. 50	
9.0 CONCLUSION	51
REFERENCES.....	53

FOREWORD

The slow pace of monetary integration in West Africa which began with the launch of the ECOWAS Monetary Cooperation Programme (EMCP) in 1987 has triggered a growing interest in financial market integration against the backdrop of the rapid expansion in cross-border financial activities. Financial integration is now considered a critical pillar for accelerating the pace of economic and monetary integration including establishment of a credible monetary union given that financial markets have taken the lead in intermediating funds across the sub-region.

The Study presents solid analytical and empirical analysis on the progress of ongoing efforts towards financial integration among six West African States (The Gambia, Ghana, Guinea, Liberia, Nigeria and Sierra Leone). It also calibrated the prospects and challenges in the process of integrating financial markets including the formation of a monetary union in the sub-region. The Paper is well-researched, covering virtually every aspect of financial integration; with issues ranging from cross-border banking, capital and insurance market integration and the liberalization of capital accounts. This book is a valuable contribution to the African development literature on regional integration and financial sector development. It will provide researchers and students with a deep repository and body of knowledge as well as an exciting chance of undertaking further research in the area of financial integration. It will also help policymakers to identify and build on the progress made in integrating financial markets as well as to introduce new policies and programmes to overcome the current obstacles to the process.

Dr. Eunice N. Egbuna, former Director of the Financial Integration Department at the West African Monetary Institute (WAMI) and her colleagues of the same Department have written this Paper on the subject of Financial Integration in the WAMZ. The evidence of the extensive detail in the book derives from the rich field of experience of Dr. Egbuna and her colleagues.

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Director General

West African Monetary Institute

July, 2016

PREFACE

The last 10 years have witness dramatic changes in the financial sector of Member States of the West African Monetary Zone (The Gambia, Ghana, Guinea, Liberia, Nigeria and Sierra Leone) particularly with the rise in cross-border banking activities. These activities, which were and continued to be dominated by Nigerian bank subsidiaries, were precipitated by the consolidation of Nigerian banking industry in 2005. Additionally, the localization of subsidiaries continued to be influenced by the increasing level of trade, relatively low minimum capital requirement in other countries and the perceived interest rate differentials between Member States. These developments have led to increased cross-border capital flows especially on account of the financial products offered by these banks. For instance, Ecobank's Rapid Transfer is targeted towards facilitating cross-border flow of funds. In addition, financial groups such as Ecobank Transnational Incorporated (ETI) are listed on the Ghana Stock Exchange (GSE), Nigerian Stock Exchange (NSE) and BVRM albeit under different listing requirements and Mnemonics.

The expansion in cross-border banking gave rise to the need for close supervision of banks through deeper banking sector integration, especially against the backdrop of recent financial crises and the need to prevent contagion. Since the global financial crisis had showed that financial instability can occur even in an environment where monetary policy had achieved low and stable inflation, sound monetary policy is a necessary but not a sufficient condition for financial stability and sustainable economic growth. Safeguarding the stability of banks

and other financial intermediaries has therefore been given greater emphasis by regulators. In the WAMZ, this had been achieved through the establishment of the College of Supervisors of the WAMZ (CSWAMZ) in 2010.

The need to foster capital market integration also came to the fore on account of larger cross-border flows as well as the need to promote access to larger markets. The West African Capital Market Integration Council (WACMIC) was set up in 2013 to spearhead the integration of capital markets in the region. The process of deepening financial integration is currently market driven; it does not only provides the building blocks for the launch of single currency in West Africa but also presents unique opportunities to enhance efficiency of financial markets with collateral benefits on growth and development. This is the first authoritative work of financial integration in the WAMZ and will represent an essential body of knowledge for anyone interested in regional economic integration and financial sector development in West Africa and Africa as a whole.

This Paper is well-researched, deploying solid empirical and analytical methods to present findings and defend its assertions. The analyses and finding were treated and presented in a comprehensive manner to give readers the chance of applying the concepts used in the book.

The Paper would not have been possible without the invaluable contributions of members of the Operations Committee of the West African Monetary Institute. It is the result of collaborative efforts among staff of

the Financial Integration Department of WAMI, which has been the centre of undertaking technical preparations for monetary and financial integration in the

WAMZ. It also benefited from comments on earlier draft from staff central banks and ministries of finance of the WAMZ as well as External Reviewers.

EXECUTIVE SUMMARY

In the WAMZ, financial integration is considered an integral element of the overall regional economic integration agenda. Total financial integration in the WAMZ will imply that financial institutions, markets and infrastructure are merged across the zone. Specifically, the WAMZ financial integration programme encapsulates: full capital account liberalization; capital market integration; regional currency convertibility/quoting and trading in WAMZ currencies; harmonization of banking supervision practices; and cross-border payments systems. The level of development in the financial sector varies across WAMZ countries albeit a few broad generalizations. The banking sector dominates the WAMZ's financial system, while stock and bond markets represent limited alternatives for raising funds. Non-bank financial institutions (NBFIs) including insurance companies, pension funds, finance houses and micro finance institutions (MFIs) are nonetheless steadily emerging and making remarkable strides in member countries. Money market operations are now fully developed in all member countries while debt and capital markets are generally underdeveloped except in Nigeria and Ghana, where there are fairly well developed and vibrant capital markets. In addition, both Nigeria and Ghana issue long tenured debt instruments.

The banking sector dominates the financial systems of Member States, accounting for over 70 percent of total financial sector assets. The size of the banking sector continues to expand rapidly both in terms of assets, number of banks and bank branch penetration. The increase in bank assets was mainly funded by the growth in deposit

mobilization which also increased over the last decade. Furthermore, the asset expansion has been supported by increases in minimum capital requirement across the Zone and the rise in the number of cross-border bank subsidiaries. Currently, Nigerian banks dominate the banking industry in the WAMZ. Ten (10) Nigerian banks have cross-border presence within the Zone with vast network of subsidiaries and bank branches. However, foreign ownership of banks remains prevalent across Member State with the exception of Nigeria. Furthermore, while bank branch penetration is improving, it remains low (an average of 0.3 per 1000 inhabitants), underpinning the low level of financial inclusion. Despite the rapid growth in the banking sector, financial intermediation measured by private credit to the rest of the economy remained sluggish. Both private sector credit to GDP and money supply to GDP increased only marginally between 2010 and 2015. The sluggish level of financial depth and intermediation in the WAMZ underscores the need to deepen the recent reforms aimed at expanding access to finance as well as policies to attract investment into the sector. The various reforms including the review of banking and financial laws and regulations in line with international benchmarks will be very critical to the development and integration of markets in the zone.

The WAMZ financial system has remained relatively stable in spite of the prevailing uncertainties in global financial environment. Reforms in regulatory and supervisory policies in addition to prudent monetary and fiscal policies reinforced the resilience of the financial sector and the sustenance of

financial stability. There has been a general improvement in the capital adequacy of banks, as Member States continued to increase the minimum capital requirement for banks, coupled with the desire of some banks to strengthen their capital bases, mainly, through capital injection via equity. The average risk weighted capital adequacy ratio (CAR) of the banking industry remained significantly higher than the 10.0 percent minimum requirement in all WAMZ countries. Liquidity and profitability also remained strong across the Member States. However, improving asset quality remained a challenge as non-performing loans remained high.

The scale and complexity of the operations of non-bank financial institutions (NBFIs) vary across Member States, reflecting the different levels of financial market development in the Zone. Whereas Ghana and Nigeria have several NBFIs including securities and brokerage companies, finance houses, development finance institutions (DFIs), mortgage finance institutions (MFIs), leasing companies, these institutions are largely absent in The Gambia, Guinea, Liberia and Sierra Leone. However, following the establishment of the stock exchange in Sierra Leone in 2007, three securities brokerage companies were licensed in 2011. The insurance sector in the WAMZ has witnessed remarkable development in recent years, evidenced by the growth in gross premiums in all countries. The number of life, non-life and reinsurance companies as well as licensed insurance brokers and loss adjusters continue to increase in all countries. In addition, confidence levels in insurance companies continue to improve particularly in Ghana and Nigeria.

Three stock markets currently operate in the WAMZ, namely; the Ghana Stock Exchange (GSE); the Nigeria Stock Exchange (NSE); and the Sierra Leone Stock Exchange (SLSE). However, the SLSE which was established in 2007 continued to have only one listed company. The performance of the Ghana Stock Exchange (GSE) has been mixed. The GSE composite index posted negative returns in 2009 and 2011 but positive returns in 2010, 2012 and 2013. High market uncertainty occasioned by the 2008 elections and the relatively high interest rates on money market instruments explained the negative returns of the index in 2009. The decline in the index in 2011 was, however, on account of the lingering effects of the global financial crisis which led to the liquidation of foreign holdings on the GSE. Macroeconomic stability coupled with the declining interest money market rates was responsible for the improved performance in 2010 while the performance in 2012 was on account of improve profitability of listed firms as well as the rise in market capitalization. The performance of the NSE mimicked that of the GSE with the NSE All Share Index declining in 2009 and 2011 but increasing in 2010, 2012, and 2013 (see Figure 3). The adverse effects of the global financial crisis, losses in the equity share prices of some quoted companies, and delisting of 64 securities involving 11 equities and 53 fixed income securities - all due to an unfavourable operating environment mainly explains the poor performance of the index in 2009 while the persistence of the global financial crisis and the resultant sluggish returns of financial stock especially bank stock explains the decline in the index in 2011. On the other hand, the positive return of the index in 2010 was on account impressive earnings of listed

entities coupled with the stable macroeconomic environment which boosted investors' confidence.

In relation to capital account liberalization, Member States were at different stages, although they were working assiduously toward full liberalization. Whereas capital inflows, especially long term non-debt bearing capital are generally unrestricted within the WAMZ Member States, various restrictions on outflows exist. However, regarding the extent of restrictions, The Gambia is the only country in the WAMZ where there are no restrictions on capital flows. Various forms of capital account restrictions ranging from ownership of real estate to provisions relating to commercial banking and institutional investors, controls could be found in Ghana, Guinea, Liberia, Nigeria and Sierra Leone. In terms of the degree of financial integration, the average lending rates which typically reflect the cost of doing business shows evidence of minimal convergence although the rates remained in double digits in all Member States. On the

other hand, the savings rate which measures the propensity to save, and by extension, a determination of the level of availability of funds for investment purposes also showed evidence of minimal convergence in 2013 although convergence in earlier period had been much better. The interest rate spread in member countries mirrored the trend in the average lending and savings rates with minimal level convergence. These findings indicate that while there have significant efforts to deepen financial sector integration in the WAMZ, the level of financial integration remained shallow with minimal convergence of interest rates. The main reason for this phenomenon is due to the prevalence of several obstacles including differences in the economic, legal and regulatory policies hindering cross-border capital market transactions, restrictions on capital account transactions, infrastructure bottleneck such as weak information communication technology (ICT) and regulatory arbitrage relating to minimum capital requirements for banks and other financial institutions, among others.

1.0 INTRODUCTION

The realization of a Single Market in financial services is an imperative to increasing the competitiveness of the WAMZ economy as a group. By dipping financial barriers between Member States, output gains are expected, which in turn engender a more efficient and competitive WAMZ financial sector. This is important, not only for the financial sector but also for all other sectors that rely on access to competitive sources of funding. In the WAMZ, financial integration is considered an integral element of the overall regional economic integration agenda. Total financial integration in the WAMZ will imply that financial institutions, markets and infrastructure are merged across the zone. The integration of financial markets in the WAMZ is expected to reduce the cost of capital and debt, improve market liquidity, and provide new investment instruments as well as provide opportunities for risk diversification across the Zone. The expansion of cross-border banking activities as well as regional capital flows in recent years is not only redefining the financial landscape but also prognosticates that financial markets in the WAMZ are on the integrating trajectory. The rising levels of regional trade, relatively low minimum capital requirement in other countries and the perceived interest rate differentials is persuading enterprises to move across border irrespective of the existing barriers to cross-border investment. Money and capital markets have remained vibrant over the last two years, just as money market interest rates remained relatively stable. Improvements in the regulatory and supervisory policies of Member States also supported the increase in banking activities through the expansion in bank balance sheets.

Although the increase in cross-border activities of financial market increases member countries' vulnerability to financial contagion, it also provides the opportunity for sharing risks precipitated by such contagion. Negative shocks in one market could easily be counter-balanced by positive developments in other markets. For instance, while the 2008 banking crises in Nigeria adversely affected some bank groups including, Intercontinental and Oceanic Banks, their subsidiaries were very buoyant in other jurisdictions. Overall, deeper financial sector integration is required in a monetary union arrangement, including the WAMZ, to enhance monetary policy transmission through the convergence of short-term interest rates and even distribution of liquidity. The WAMZ programme for financial integration encapsulates: full capital account liberalization; cross-listing of stocks; regional currency convertibility/quoting and trading in WAMZ currencies; harmonisation of banking supervision practices; and cross-border payments systems. The WAMZ programme on financial integration is extracted from the *Banjul Action Plan* of 2007 which was later restated in the 2009 as the *Abuja Roadmap*. Taking together in an organically integrated framework, these two agenda are given expression in the WAMI Strategic Plan 2010 – 2015. However, full integration of financial markets in the WAMZ has been challenged by subsistent differences in the economic, legal and regulatory policies as well as infrastructure bottlenecks such as weak information communication technology (ICT) across the sub-region. Furthermore, existing capital account restrictions such as limits of foreign

ownership of financial securities and real estate by residents represent a significant barrier to the cross-border flow of funds and by extension the pace of financial market

integration. Moreover, there is limited cross-border trade in insurance services on account of the fragmented legal and regulatory frameworks.

2.0 THE REGIONAL FINANCIAL STRUCTURE

This section contains a detailed overview of the structure of WAMZ's financial system, in order to shed light on the nature of the financial systems, changing structure of financial services as well as significant regulatory and policy development.

2.1 Evolution of the financial sector in the WAMZ (2009-2013)

The nature and level of financial sector development varies across WAMZ countries permitting a few broad generalizations. Overall, the banking sector dominates the

WAMZ's financial system, while stock and bond markets remains a minor alternative option for raising funds. However, non-bank financial institutions (NBFIs) including insurance companies, pension funds, finance houses and micro finance institutions (MFIs) are steadily emerging and making remarkable strides in the member countries. While money market operations are now fully developed in all member countries, debt and capital markets are generally underdeveloped except in Nigeria and Ghana that have a fairly well developed and vibrant capital markets. Both Nigeria and Ghana issue long tenured debt instruments.

Table 1: Generic Features of the Banking Sector in the WAMZ

Country	Number of Banks				Number of Bank Branches				Number of Foreign Banks			
	2010	2011	2012	2013	2010	2011	2012	2013	2010	2011	2012	2013
The Gambia	13	13	13	12	72	74	76	80	12	12	12	11
Ghana	26	25	26	27	379	814	862	892	13	14	14	15
Guinea	11	12	14	15	75	76	96	109	11	12	14	15
Liberia	8	9	9	9	66	78	79	82	7	8	8	8
Nigeria	24	20	21	22	5797	5850	5050	5072	4	4	4	4
Sierra Leone	13	13	13	13	81	83	87	95	10	10	10	10

Sources: WAMZ Authorities and WAMI staff Estimates

In **The Gambia**, financial sector activities continued to be dominated by the banking sector. The number of banks declined to thirteen (13) in 2010 from fourteen (14) in 2009 following the exit of Oceanic Bank. In 2012, another bank (Skye Bank) was granted voluntary liquidation, bringing the total number of banks to 12. The number of bank

branches consequently decline to 76 in 2012 from 77 in 2009. The majority of the banks

were foreign owned banks¹. In addition, the minimum capital requirement for banks was raised from D150 million in 2010 and to D200 million in 2012, with no regulatory forbearance. On the other hand, the number of insurance companies increased to twelve (12) from eleven (11) in 2011. The new entrant to the industry is Enterprise Life Assurance Company (ELAC Gambia Ltd). In terms of ownership structure, six (6) companies were locally owned, two (2)

foreign owned and four (4) were of mixed ownership. Nine (9) of the twelve (12) insurance companies in the country underwrite general business (non-life business). Two (2) are wholly life insurers, and one (1) is a composite insurer. There are sixty-two (62) microfinance institutions, five (5) finance companies, 57 credit unions and village savings and credit associations (VISACAs).

Box 2.2: Recent Capital Augmentation in the WAMZ

The Gambia increased minimum capital for banks from US\$ 2.3 million to US\$ 5.2 million at end 2010 and then to US\$ 6.9 million at end 2012.

In *Ghana*, local banks were given up to December, 2010 to meet the US\$ 17.0 million minimum capital requirement and up to December, 2012 to meet the US\$ 40.0 million requirement, while the minimum capital for foreign banks was increased to US\$ 40.0 million in December 2009.

The minimum capital for banks in *Guinea* was increased from US\$ 6.5 million in 2010 to US\$ 7.2 million in 2011

Nigeria revoked its universal banking model in 2010 and introduced new capital requirements for different categories of commercial banks:

- i) US\$ 166.6 million for national banks;
- ii) US\$ 66.2 million for regional banks; and
- iii) US\$ 331.1 million for international banks.

Liberia increased the minimum capital for banks from US\$ 8 million to US\$10 million in December 2010.

In *Sierra Leone*, the minimum capital for banks was raised to US\$ 6.2 million in 2012 with plans to further increase it to US\$ 7.0 million in 2013

Source: WAMZ Member Countries

¹ A foreign owned bank is a bank that is incorporated in the country but with majority of the shares owned by non-resident.

In Ghana, the Industry was characterized by Mergers and Acquisition as Ecobank bought the assets of Trust Bank in 2012 while Access Bank took over Intercontinental Bank in 2011. The number of banks consequently declined to 25 from 27 in 2010. However, one new bank was licensed in 2012 bringing the total number of banks to 26 by 2013. In addition, the minimum capital requirement was revised in 2009. Local banks given up to December, 2010 to meet the GH¢25 Million and GH¢60 Million by end-December, 2012. Foreign banks on the other hand were given up to December 2009 to meet the GH¢ 60 Million requirement. All deposit money banks are currently required to meet the GH¢ 60 Million minimum paid-up capital while new entrants are required to meet GH¢ 60 Million. There are currently 138 rural and community banks operating under an Apex Bank arrangement. The total number of insurance companies operating in Ghana remained at 43, consisting of 18 life, 23 non-life and 2 reinsurance companies. 40 broking companies, one reinsurance broking company and one loss adjusting company were also in operation during the review period. In addition, there are twenty-five (25) finance companies, nineteen (19) savings and loans companies, three (4) leasing companies and one (1) mortgage finance company operated in the country.

In Guinea, the number of commercial banks increased from eight (8) in 2008 to eleven (11) in 2009. Three more banks were granted operating licenses in mid-2010 bringing the total number of banks total number of banks to 14. However, in 2012, two of the 14 licensed deposit money banks (DMBs) had their licenses withdrawn; one for failure to use it license during the regulatory period,

and the other for insolvency. A third licensed bank was yet to begin operations. On the other hand, the number of bank branches increased to 75 in 2010 to 109 in December 2013. There are currently nine (9) micro-finance institutions that are supervised by the Central Bank while two new insurance companies were licensed, bringing the total number of operators to 9 from 7 in 2011. In 2010, there were only 5 insurance companies. One Insurance company which was under temporary administration was recapitalized with the sum of GNF 6 billion by the Government of Guinea in 2012. The distribution network of insurance companies comprises of 55 brokers and 48 general agents, out of which 25 operated in the hinterland and 23 within the capital city Conakry.

The financial landscape **in Liberia** continued to record significant progress even though the number of banks has remained unchanged at nine (9), since 2009. In 2010, several new bank branches were established throughout the country, raising the total number of branches in the country to 74 from fifty-six (56) branches in 2009. It later increased to 82 in 2013 from 78 in 2012. Banking services are currently being provided in eleven (11) of the fifteen (15) counties compared with nine (9) counties in 2009. The insurance sector was completely overhauled with the introduction of the Insurance Reform Road Map (IRRM) in September 2011 by the Central Bank Liberia when it took over of the supervision of insurance companies from the Ministry of Transport. The IRRM incorporated capitalization, corporate governance, adequate risk management standards as well as the stipulated reinsurance cover that was to be met by all insurance companies as at end-2012. In this

regard, 12 insurance companies met the reform requirements while an additional 12 companies were given up to end-2013. A new Insurance Bill has been prepared and laid before the Legislature for passage into law in order the regulation of the sector. The number of microfinance institutions increased to 10 in 2012 from 7 in 2010.

The fall out of the 2007-2008 financial crisis adversely affected **Nigeria's** financial sector and left banking system in turmoil, remedied only by the intervention of the Central Bank of Nigeria (CBN). Of the Twenty-four (24) banks in operation in 2009, only fourteen (14) banks met the minimum capital and liquidity thresholds while nine (9) banks were found to be in grave situation with another bank adjudged to have insufficient capital but had a healthy liquidity position. Weak risk management and poor corporate governance pushed these nine (9) into financial distress. This development triggered the removal of eight (8) Managing Directors and some other Executive Directors of the affected banks in order to restore confidence and ensure financial stability. The CBN instituted Interim Boards and Managements and injected ₦620.0 billion Tier 2 Capital into the affected banks. The bail-out resources were structured as seven (7) year long term convertible loans at 11 percent but later reduced to 8 percent and callable on the fifth anniversary of the loan. However, the banking system continued to be inundated by solvency concerns in 2010 with ten (10) banks failing to meet the minimum Capital Adequacy Ratio (CAR) of 10 percent. This prompted the CBN to set up the Asset Management Corporation of Nigeria (AMCON) as a vehicle to recapitalize them

by buying their toxic assets. The CBN also revoked the universal banking model and introduced more stringent regulations aimed at strengthening corporate governance and enhancing risk management. Consequently, the number of deposit money banks declined from twenty-four (24) in 2010 to twenty (20) in 2011, although it later increased to twenty-two (22) in 2013.

In addition, there are currently twenty (20) Merchant Banks, one (1) Non-interest Bank, five (5) Discount Houses, five (5) Development Finance Institutions, sixty-four (64) Finance Companies, eighty-two (82) Primary Mortgage Institutions, 726 Bureau De Change, and 869 Microfinance Banks. Two merchant banks, namely Rand Merchant Bank Nigeria Ltd (a subsidiary of First Rand Bank of South Africa) and FSDH Merchant Bank Limited² were licensed in 2012.

Developments in the financial sector in **Sierra Leone** remained optimistic despite the withdrawal of one bank in 2010 following its inability to meet the new minimum capital requirement. Thus, the number of deposit money banks declined to thirteen (13) in 2010 from fourteen (14) in 2009. It has since remained unchanged at 13 although the number of bank branches has expanding steadily to 95 in 2013 from 87 and 81 in 2012 and 2011, respectively. The Bank of Sierra Leone (BSL) increased capital requirements for deposit money banks to Le18 billion in 2010 from Le15 billion in 2009, with further graduated increases to Le30 billion over four years. All Banks were required to meet the Le27 billion 'minimum paid-up capital' by end 2013. Non-bank financial institutions are also developing. Currently, there are 2

² FSDH transformed from a discount house

discount houses, 9 community banks, 10 insurance companies, 8 microfinance institutions, 52 Foreign exchange bureaus and 1 mortgage finance bank.

Ultimately, the recent expansion in the number and size of banks is noticeably changing the financial sector configuration. Majority of banks are now foreign owned,

representing cross-border subsidiaries of large financial groups originating mainly from Nigeria. Furthermore, the localization of subsidiaries continued to be influenced by the increasing level of trade, relatively low minimum capital requirement in other countries and the perceived interest rate differentials.

Box 2.1: Recent Developments in the Nigerian Banking Sector

Mergers/Acquisitions

1. *In 2011, Intercontinental Bank was acquired by Accessbank while Ecobank took over Oceanic Bank. In particular, the acquisition of Intercontinental Bank Plc made Access Bank Plc one of the top three banks in Nigeria as it benefited from a large retail customer base and a sophisticated IT infrastructure. On the other hand, Ecobank also leveraged on the large market share of Oceanic Bank.*

Asset Management Corporation of Nigeria (AMCON)

2. *Asset Management Corporation of Nigeria (AMCON) was established to acquire eligible non-performing assets of banks and to recapitalize ailing banks. As at June 30, 2013, the Corporation had acquired eligible bank assets as well as injected fresh capital into the undercapitalized banks worth over US\$ 22.3 billion.*

Review of the Universal Banking Model

3. *The Universal Banking (UB) Model introduced on January 1, 2001 was reviewed in 2010 and replaced with a new banking model with a specific-purpose bank licensing regime prohibiting banks from undertaking insurance marketing, asset management, and capital market activities. The new regime categorizes banks into commercial, merchant and specialized banks with different capital requirements. The guidelines for the new banking model mandated banks to divest all non-banking subsidiaries by end-2012.*

Review of the Prudential Guidelines

4. *In order to address the flaws in the Prudential Guidelines that were issued on November 7, 1990, new prudential guidelines were issued to reflect the current dynamics in the industry and provide guidance on recognition of income, establishment of loan loss allowances, credit risk disclosure and related matters.*

Guidelines on Margin Lending

5. *The CBN issued guidelines on margin lending to address the lapses observed during the 2009 special examination of banks. The guidelines are intended to, among others, improve risk management, transparency and disclosure in reporting by market operators.*

Tenure Regulation of Banks' Executives and Auditors

6. *The CBN issued a regulation restricting the tenure of managing directors of banks to a maximum of 10 years. The regulation also barred the Governor, Deputy Governors, and Departmental Directors of the CBN from holding office in the banking industry for specified periods after their exit from office.*

Source: CBN

2.2 Financial depth and size of the banking system

The WAMZ financial sector has been expanding since 2010 along with the expansion in bank assets, accounting for about 75 percent of total financial sector assets. All WAMZ countries had continued to record significant increases in bank assets since 2010 (see Table 2). Total bank assets have expanded by an average of 11.1 percent since 2010. The increase in assets was mainly funded by the growth in deposit mobilisation which also increased over the same period (by an average of 2.2 percent). Furthermore, the asset expansion has been supported by increases in minimum capital

requirement across the Zone (see Box 2) and the number of cross-border bank subsidiaries. As mentioned earlier, majority of the cross-border bank are Nigerian owned, a scenario that was precipitated by the consolidation of the Nigerian banking industry in 2005, when higher capital requirements encouraged banks to seek additional markets in order to expand profit opportunities. The location of subsidiaries was also influenced by the increasing level of trade, relatively low minimum capital requirement in other countries and the perceived interest rate differentials.

Table 2: Size of the WAMZ Banking Sector

Country	Bank Assets (million USD)				Bank Deposits (million USD)				Bank Credit (million USD)			
	2010	2011	2012	2013	2010	2011	2012	2013	2010	2011	2012	2013
The Gambia	603.3	583.4	661.0	603.9	410.1	435.5	459.7	379.1	171.0	181.0	190.5	157.8
Ghana	11,816.65	13,453.0	14,224.5	16,440.8	8,026.0	10,323.2	10,226.2	10,605.3	2,192.0	6,037.7	6,800.6	7,747.0
Guinea	1,134	1,536.0	1,428.3	1,637.00	1,164.0	1,164.0	1,082.6	1,261.0	222.0	445.0	429.5	568.0
Liberia	550.10	712.4	763.6	839.60	396.0	494.0	531.5	584.6	222.0	223.0	259.9	311.8
Nigeria	104,554.77	113,762.5	135,409.0	149,282.6	71,296.9	80,327.4	92,398.7	106,145.6	47,462.0	47,853.6	52,344.5	63,642.1
Sierra Leone	581.6	681.3	834.9	993.8	434.9	526.1	652.8	790.1	208.4	244.9	265.5	294.0
Total WAMZ	119,240.4	130,728.6	153,321.3	169,797.7	81,728.0	93,270.2	105,351.5	119,765.7	50,477.4	54,985.2	60,290.5	72,720.7

Source: WAMZ Authorities and WAMI Staff Estimates

Currently, Nigerian banks dominate the banking industry in the WAMZ. Ten (10) Nigerian banks have cross-border presence within the Zone with vast network of subsidiaries and bank branches. The banking industry has also witnessed several mergers and acquisitions since 2011. Access Bank acquired the assets of Intercontinental Bank while Ecobank Nigeria took over Oceanic Bank. In 2013, First Bank of Nigeria bought the West African Subsidiaries of International Commercial Bank while Ecobank Ghana merged with Trust Bank of

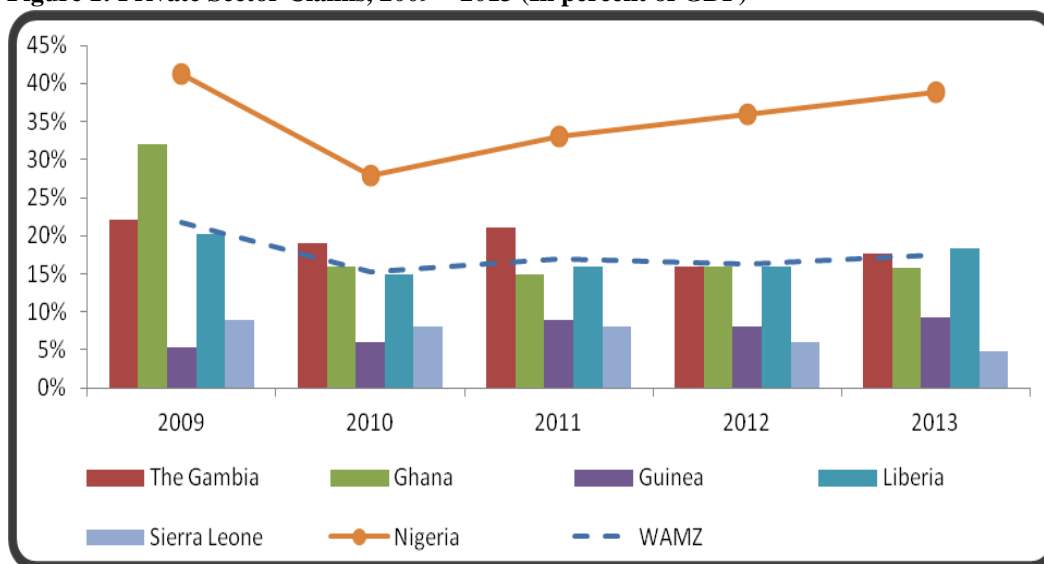
Ghana. The mergers or acquisitions were necessitated by the need to expand market share, leverage on the infrastructure and customer base of acquired banks as well as to strengthen compliance with regulatory and prudential requirements as financial reforms were deepened across the Zone.

Despite the rapid growth in the banking sector, financial intermediation measured by private credit to the rest of the economy remained sluggish, below 30.0 percent of GDP. The overall private sector credit to

GDP ratio rose to 17.5 percent in 2013, from 16.4 percent in 2012, after declining from 17.0 percent in 2011. With exception of Sierra Leone, the ratio increased in all countries during 2013. The general increase in private sector claims to GDP in other Member States is supported by the rise in bank credit (Table 2, column 10 – 13). In particular, gross loans and advances in the WAMZ increased by an average of 16.5 percent from 2010 through 2013. Figure 1 shows that Nigeria has the highest level of

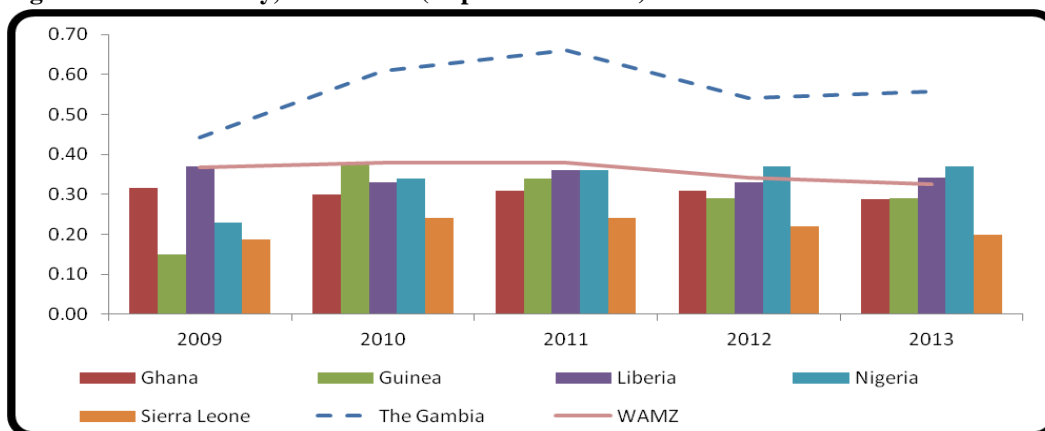
financial intermediation in Zone as its ratio of private sector credit to GDP is higher than the WAMZ average. The level of intermediation in the Zone is expected to improve considerably in the medium term giving the on-going reforms, such as introduction of credit reference bureaus and collateral registries and the establishment of rural banks and microfinance institutions, to deepen access to finance being implemented by member countries.

Figure 1: Private Sector Claims, 2009 – 2013 (In percent of GDP)



Financial depth, measured by broad money supply (M2) to GDP, had showed a declining trend since 2009 (See Figure 2). In 2013, it declined to 32.5 percent from 34.3 percent in 2012, on account of the reduction in the growth of money supply in Ghana and Sierra Leone. On the whole, the level of financial depth had stagnated around 34.0 percent between 2009 and 2013. The sluggish level of financial depth in the zone underscores the need to deepen the recent reforms aimed at expanding access to finance as well as policies to attract investment into the sector. The various reforms including the review of banking laws and regulations, adoption of International Financial Reporting Standards (IFRS), Risk-based Supervision (RBS) and Basel II and III principles as well as the strengthening of anti-money laundering and combating financing of terrorism (AML/CFT) among others, will be very critical to the development and integration of markets in the zone.

Figure 2: Broad Money, 2009 –2013 (In percent of GDP)



2.2.1 Financial Soundness Indicators

Despite the prevailing uncertainties in the global financial environment, the WAMZ financial system has remained relatively stable. Reforms in regulatory and supervisory policies in addition to prudent monetary and fiscal policies reinforced the resilience of the financial sector and the sustenance of financial stability. There was a general improvement in the capital adequacy of banks, as Member States continued to increase the minimum capital requirement for banks, coupled with the desire of some banks to strengthen their capital bases, mainly, through capital injection via equity. The average risk weighted capital adequacy ratio (CAR) of the banking industry remained significantly higher than the 10.0 percent minimum requirement in all WAMZ countries (see Table 3).

Improving asset quality has remained a challenge for most member countries. With exception of Guinea and Nigeria, the ratio of non-performing assets to gross loans (NPLs) has remained in double digits, relatively

higher than the 10.0 percent tolerable limits. Consequently, the amount of risks held by banks in the Zone relative to their capital has increased as evidenced by the increase in provisions coverage³ in most countries (The Gambia and Nigeria). The high level of NPLs reflects increasing credit risks on account of high lending rates, lapses in corporate governance in some banks and continued prevalence of legacy loans in the accounting books of some banks. In Nigeria, the acquisition of toxic assets of some banks by AMCON, as well as efforts by the CBN to improve risk management and corporate governance in the banking system led to significant decline in NPLs, from 15.5 percent in 2010 to 3.5 percent in 2012.

With the exception of Liberia, bank profitability had been improving across the Zone since 2011. In 2013, Return of Assets (ROA) was above 2.0 percent in all countries, except Liberia and The Gambia. In addition, Return on Equity (ROE) had been significantly higher, above 10.0 percent in most countries except Liberia, were it was

³ NPLs net of provisions

negative. High interest margins as well as increases in commission and fees explain the relatively strong levels of profitability across the Zone. In Liberia, profitability remained weak as both ROA and ROE were negative due to multiple reasons. High NPLs due to poor repayment culture, weak credit administration in banks and legacy loans, limited investment options for banks, poor innovation by banks as well as high operational cost explain the relatively weak level of profitability in Liberia. Liquidity of the banking industry also remained strong

across member countries (see Table 3). Overall liquidity in most Member States generally exceeds the 30.0 percent international benchmark. This development suggests that banks generally have a strong capacity to meet short term obligations as well as unexpected demand for cash. However, the prevalence of the high level of liquidity across the zone is indicative of the sluggish pace of credit growth and thus stressing the need to strengthen financial intermediation in the Zone.

Table 2: Selected Financial Soundness Indicators of the Banking Industry

	The Gambia			Ghana			Guinea			Liberia			Nigeria			Sierra Leone		
	2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013
1. Asset Based Indicators																		
NPL to total gross loans	12.6	16.5	13.9	14.2	13.2	12.0	2.8	1.9	5.3	20.8	24.7	14.8	5.3	3.5	3.2	15.1	14.7	22.4
Liquid assets (core) to total assets	54.3	51.9	49.5	43.7	38.7	40.1	n/a	n/a	n/a	30.7	31.9	25.2	25.7	24.7	22.2	6.1	5.6	8.1
Liquid assets (core) to short-term liabilities	75.3	81.5	87.7	92.0	77.3	108.3	78.3	66.4	75.6	45.6	44.7	55.5	31.2	28.9	25.2	7.2	6.5	9.4
Return on assets (ROA)	0.3	2.2	1.8	3.9	4.9	6.2	2.5	3.0	2.2	-0.7	-0.1	-0.5	0.1	0.8	2.3	3.8	3.7	2.1
2. Capital Based Indicators																		
Regulatory capital to risk-weighted assets	24.8	30.0	26.5	17.4	18.6	18.5	17.7	23.0	27.6	22.8	22.7	24.8	17.9	18.3	17.2	27.0	28.0	30.1
NPLs net of provision to capital	27.9	10.6	12.6	36.6	40.7	47.1	8.0	10.3	20.6	45.0	60.0	44.4	10.1	6.1	7.4	21.4	21.1	31.6
Return on equity (ROE)	0.5	12.5	12.7	19.7	25.8	30.9	30.9	22.0	18.5	-4.7	-0.5	-3.8	0.5	7.8	19.8	15.6	17.4	9.7
3. Income and Expense Based Indicators																		
Interest margin to gross income	37.1	34.3	31.5	46.8	10.9	12.58	152.9	182.6	100.0	3.8	3.9	4.6	42.2	63.3	64.9	48.8	51.0	48.8
Non-interest expenses to gross income	59.5	55.8	52.1	53.0	39.1	34.44	128.3	180.0	56.0	75.9	74.5	78.2	75.4	64.1	68.9	57.3	56.9	61.4
Personnel expenses to non-interest expenses	31.7	38.0	44.3	45.1	36.0	36.49	38.7	32.0	38.8	66.7	48.3	37.1	36.1	44.5	36.5	37.2	37.0	36.7

Source: WAMZ Authorities and WAMI Staff Estimates

On the whole, the financial soundness indicators generally indicate that the banking industry across the WAMZ remained stable. However, downside risks to financial soundness subsist and relate to the high operational costs and increased market risk, following the spate of foreign exchange pressures in Member States. In addition, lending rates remained high in Member States (see Figure 4) and this could potentially increase the probability of loan

defaults in the future, thereby, deteriorating the quality of bank loan portfolios (high NPLs). In particular, NPLs remained in double digits from 2011 through 2013 in most countries with the exception of Guinea and Nigeria. This underscores the need for Member States to adopt bold and proactive policies to address high NPLs including sound risk management and corporate governance as well as encouraging compulsory loan write-offs. In addition,

banks in the Zone should enhance profit opportunities by seeking firms and business areas with high growth potential while at the same time deepening financial innovation. Profitability could also be enhanced by improving efficiency through a reduction in operating costs, and by enhancing the effectiveness of risk management, particularly, credit and market risks.

2.2.2 Non-bank Financial Sector in the WAMZ

The scale and complexity of the operations of non-bank financial institutions (NBFIs) vary across Member States, reflecting the different levels of financial market development in the Zone. Whereas Ghana and Nigeria have several NBFIs including securities and brokerage companies, finance houses, development finance institutions (DFIs), mortgage finance institutions (MFIs), leasing companies, these institutions are largely absent in The Gambia, Guinea, Liberia and Sierra Leone. However, following the establishment of the stock exchange in Sierra Leone in 2007, three securities brokerage companies were licensed in 2011.

In Nigeria, total assets of primary mortgage banks (PMBs) increased slightly by 2.2 per cent to US\$2.45 billion in December 2012, from US\$ 2.4 billion as at end-June. PMBs continue to intensify competition for loans and deposits in the banking system although their total asset size remains small (equivalent to about 5.0 percent of total assets of the banking system). Finance houses, mortgage companies and unit trusts have also increased competition in the financial system even though their share of total assets

remained minuscule (less than 10 percent of total financial assets).

2.2.2.1 Insurance Markets

The insurance sector in the WAMZ has witnessed remarkable development in recent years, evidenced by the growth in gross premiums in all countries. The number of life, non-life and reinsurance companies as well as licensed insurance brokers and loss adjusters continue to increase in all countries. In addition, confidence levels in insurance companies continue to improve particularly in Ghana and Nigeria.

In **The Gambia**, the number of insurance companies increased to twelve (12) from eleven (11) in 2011. The new entrant to the industry is Enterprise Life Assurance Company (ELAC Gambia Ltd). In terms of ownership structure, six (6) companies were locally owned, two (2) foreign owned and four (4) were of mixed ownership. Nine (9) of the twelve (12) insurance companies in the country underwrite general business (non-life business). Two (2) are wholly life insurers, and one (1) is a composite insurer. The numbers of brokers and agents have also expanded to eight (8) and sixty-eight (68), respectively, from seven (7) brokers and thirteen (13) agents in the previous period. The number of branches stood at a total of twenty-seven (27) and coverage spanned across the six administrative regions of the country. Assessment of the performance of the industry showed that assets, premium income and gross premium of the industry improved.

The total number of insurance companies operating in **Ghana** remained at 43 since 2011, consisting of 18 life, 23 non-life and 2

reinsurance companies. 40 broking companies, one reinsurance broking company and one loss adjusting company were also in operation during the review period. The National Insurance Commission (NIC) initiated several projects to improve both efficiency and depth of the industry. The Commission was reviewing the Insurance Act to make it relevant to current insurance market developments, especially with regard to micro-insurance and agric-insurance. The NIC issued new prudential guidelines mandating companies to submit monthly returns to the Commission through an online automated software system as a basis for migration to RBS. The Commission also issued directives for all companies to prepare their accounts in line with IFRS. An actuarial capacity development project was launched to train actuaries locally and enhance the capacity of existing actuaries to encourage insurance companies to have in-house actuaries. The Commission plans to raise the minimum capital requirement to cedi equivalent of US\$5 million from its present level of US\$1 million. Specific challenges for the industry include the factoring of risk elements into the credit policy on premium, making the industry IFRS compliant and the adoption of RBS. The National Insurance Commission was working on two memoranda of understanding on joint supervision with Nigeria and South Africa.

Two new insurance companies were licensed in **Guinea** in 2012, bringing the total number of operators to 9. It had remained 9 companies since then. One Insurance company which was under temporary administration was recapitalized with the sum of GNF 6 billion by the Government of Guinea. The distribution network of insurance companies comprises 55 brokers

and 48 general agents, out of which 25 operated in the hinterland and 23 within the capital city Conakry. A Vehicle Guarantee Fund was introduced during the review period to take charge of road accident victims in cases where accident culprits were not known or insolvent. The level of market penetration (0.50 percent) was however weak, while the sector was highly concentrated, with a single insurance company responsible for 53.4 percent of market share. However, the insurance sector continued to grapple with sundry challenges including the low level of capitalization, lack of opportunities for reinvesting the mobilized resources, high taxes on life insurance premiums and the need for reinsurance to cover the main mining companies. In **Liberia**, the Insurance Reform Road Map (IRRM) which was issued to insurance companies in September 2011 to enhance regulatory compliance was revised in 2012 to ensure flexibility upon the commitment made by the insurance companies. Requirements regarding adequate capitalization, corporate governance, adequate risk management and adequate reinsurance cover were to be met by December 31, 2012. Those companies which met the reform requirements on/before the deadline were to be licensed by the CBL to operate as legally recognised insurance companies. During the period, 10 new companies were registered, bringing the total number of insurance companies to 24 of which 12 met the reform requirements and the other 12 were given grace period up to May 31, 2013. The number of insurance brokers also rose by 2 to 3 in 2012. The total assets of the insurance industry stood at US\$29.03 million, while liabilities amounted to US\$8.61 million. To properly regulate and expand the insurance industry, a new

Insurance Bill was prepared and expected to be laid before the Legislature for passage.

The insurance sector in **Nigeria** continued to record significant improvements, reflecting the effective implementation of the National Insurance Commission's (NAICOM) strategic plan. The total premiums income for all insurance companies increased from N210 billion in 2011 to N260 billion in 2012. The number of insurance companies as at end-December 2012 stood at fifty (59), while there were two Reinsurance companies. The number of brokers and insurance agents increased from 550 and 1750 in 2011 to 579 and 2250 in 2012, respectively. The number of companies with foreign ownership also increased from three (3) in 2011 to ten (10) in 2012, mostly from South Africa. The increase in foreign ownership indicates the perception of opportunities in retail insurance markets. However, insurance penetration remained low (below than 2 percent). In this regard, NAICOM continue to implement reforms to boost the insurance sector, especially the introduction of micro-insurance and establishment of Takaful operations. The Commission also undertook a self-assessment through the Financial System Assessment Program (FSAP) in August 2012. It also released guidelines on “No Premium No Cover” and continued to work towards migration to IFRS in line with international best practices.

In **Sierra Leone**, the insurance industry continued to record strong growth with total gross premium estimated at Le 90.0 billion (US\$ 20.0 million) in 2013. Total premiums from the life and non-life businesses amounted to Le 23.4 billion and Le 66.6 billion, respectively. The number of insurance companies increased to eleven (11)

in 2013 from nine (9) in 2011 due to the licensing of one reinsurance company in 2012. However, the industry is heavily concentrated with the top five (5) accounting for about 90 percent of gross premiums while insurance penetration remained low, it increased to 0.74 percent in 2012 from 0.56 percent in 2011. The minimum capital requirement per class of business in the life and non-life sectors remained low at US\$ 53,333.3. Moreover, there is need to strengthen observance of the Insurance Core Principles (ICPs). The country currently observes only 4 ICPs, largely observes 11 and materially non-observe 2. The Sierra Leone Insurance Commission (SLICOM) was therefore reviewing the Insurance Act of 2000 to improve compliance with the ICP and raise minimum capital requirements to match the growth of the insurance sector. SLICOM established a public compliant bureau to address customer and complaints and boost the confidence levels of the general public. The Commission also recently reviewed the policies of all insurance products to improve claims handling and underwriting as well as enhance transparency.

2.3 Capital Markets

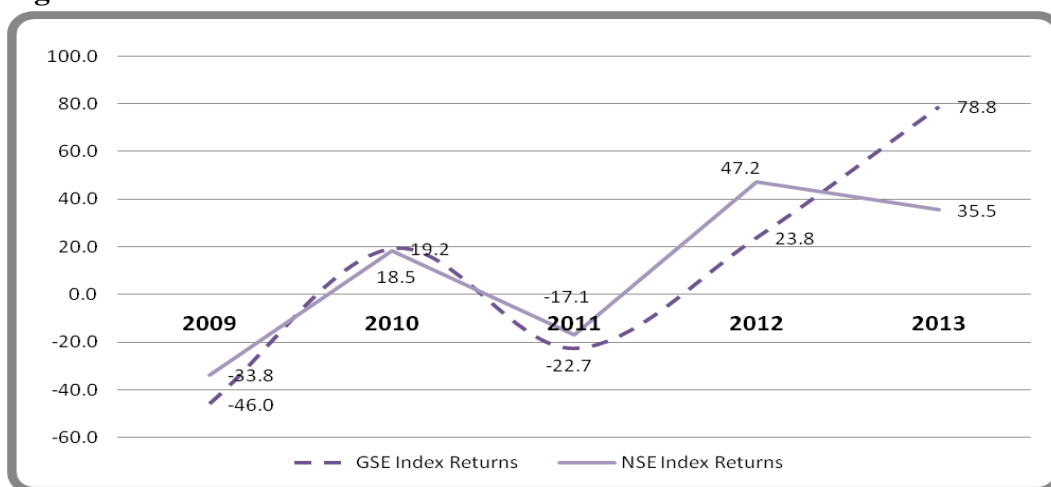
Three stock markets currently operate in the WAMZ, namely; the Ghana Stock Exchange (GSE); the Nigeria Stock Exchange (NSE); and the Sierra Leone Stock Exchange (SLSE). However, the SLSE which was established in 2007 continued to have only one listed company. Hence, only the GSE and the NSE have been vibrant markets since 2009.

The performance of the **Ghana** Stock Exchange (GSE) has been mixed. As shown

in figure 3, the GSE composite index posted negative returns in 2009 and 2011 but positive returns in 2010, 2012 and 2013. High market uncertainty occasioned by the 2008 elections and the assumption of office by a new administration in early 2009, macroeconomic instability, and the relatively high interest rates on money market instruments explained the negative returns of the index in 2009. The decline in the index in 2011 was, however, on account of the lingering effects of the global financial crisis and the fallout from Euro-zone crisis which led to the liquidation of foreign holdings on the GSE. Macroeconomic stability coupled with the declining interest money market rates was responsible for the improved performance in 2010 while the performance in 2012 was on account of improve profitability of listed firms as well as the rise in market capitalization. In 2013, the GSE

recorded its best performance as returns on the market index increased to 78.8 percent from 23.8 percent in 2012. This was mainly on account of increased investor confidence and improved performance of the listed companies, especially financial institutions. Investor confidence was largely supported by the implementation of the pension scheme reforms, especially the 2nd and 3rd tiers, which allowed pension fund managers (PFMs) to invest in certain equities. In addition, the GSE continued to implement several reforms to deepen activity on the market. Between 2010 and 2011, the trading, depository and clearing and settlements systems were automated and linked. A central securities depository was also established in 2010. The GSE introduced the GSE Alternative Market (GAX) in 2012, to target small and medium-scale enterprises (SMEs) with high growth potential.

Figure 3: Stock Market Returns in the WAMZ



In Nigeria, the performance of the NSE mimicked that of the GSE with the NSE All Share Index declining in 2009 and 2011 but increasing in 2010, 2012, and 2013 (see Figure 3). The adverse effects of the global

financial crisis, losses in the equity share prices of some quoted companies, and delisting of 64 securities involving 11 equities and 53 fixed income securities - all due to an unfavourable operating

environment mainly explain the poor performance of the index in 2009 while the persistence of the global financial crisis and the resultant sluggish returns of financial stock especially bank stock explain the decline in the index in 2011. On the other hand, the positive return of the index in 2010 was on account of impressive earnings of listed entities coupled with the stable macroeconomic environment which boosted investors' confidence. The recent capital market reforms in **Nigeria**, especially those bordering on corporate governance, market segmentation, share buyback and the introduction of Exchange Traded Funds (ETFs), led to a rebound in the activities on the Nigerian Stock Exchange in 2012, as investors began the long and arduous process of rebuilding confidence in the market. Overall, the performances of the NSE-ASI ranked fourth among the top ten member Exchanges in the World Federation of Exchange in 2012. The performance of the market remained robust in 2013, with a 35.5 percent return on the All Share Index, compared to 47.2 percent in 2013.

The compliance regime in Nigeria saw continued improvement since 2009. The Securities and Exchange Commission (SEC) initiated key reforms in 2011 aimed at reviving the fortunes of the market, engender investor confidence and promote market integrity. In particular, the SEC introduced "New Rules and Regulation" and amended nine (9) provisions of the existing "Rules and Regulations". Other reform measures introduced in 2011 were: the launch of the first Exchange Traded Fund (ETF) in Africa, new Corporate Governance Code, a Risk Based Supervision Model (RBS), and migration to International Financial Reporting Standards (IFRS) as well as an

Anti-Money Laundering/Counter Financing Terrorism (AML/CFT) Manual for Market Operators, among others. In 2012, the Commission suspended some operators from all capital market activities following their persistent failure to file returns and for a variety of regulatory infractions. It also clamped down and prosecuted the culprits of all known forms of Ponzi schemes and illegal fund managers, liaised with the CBN to ensure that such operators' accounts were frozen. To address the challenge of low market depth and breath, SEC implemented product friendly rules to encourage innovation and new products, including rules on private equity fund. Collective Investments Scheme (CIS) were also encouraged and operating guidelines were redressed. CIS fund managers were permitted to invest in unquoted companies, and fund managers were directed to segregate their assets by introducing custodial services. The Nigerian Stock Exchange launched NSE Lotus Islamic Index (NSE LII) and implemented a value added services program (Xvalue). The NSE also amended its listing rules to include quantitative measurements for profit, capitalization, price and public float, among others. It launched the Broker TraX tool and X-Compliance Report and Market Quality Report (X-Qual) to increase compliance and transparency, maintain market integrity and improve best execution of orders. Furthermore, the Over-the-Counter (OTC) market was introduced to the Exchange's business segment, through its wholly-owned subsidiary and NSE Consult.

The integration of capital markets in West Africa was revitalized in 2012 period with the convening a stakeholders' forum on Capital markets integration in West African. The event was jointly organized by the West

African Monetary Institute and Ghana Stock Exchange with the Nigerian Stock Exchange (NSE) and Bourse Régionale des Valeurs Mobilières (BRVM) in attendance. The major resolution made at the meeting was the need to establish a governance structure, consisting of a Council (West African Capital Markets Integration Council (WACMIC)) and Technical Committee which would be responsible for integrating capital markets in the sub-region. The West African Capital Market Integration Council (WACMIC) was consequently inaugurated in January 2013 in

Abuja, Nigeria, with heads of stock exchanges and Securities and Exchange Commission (SECs) as council members. The Technical Committee of WACMIC is expected to develop and harmonised listing and trading rules to facilitate cross-listing of stocks and portability of brokers. Furthermore, the process is also expected to culminate in the cross-listing of equities across regional markets. This notwithstanding, Ecobank is already listed on the GSE, NSE and BRVM under different listing requirements.

3.0 ASSESSMENT OF CAPITAL ACCOUNT LIBERALISATION

In order to increase the chances of success of the single currency programme, member countries of the WAMZ developed a comprehensive blueprint known as the “Banjul Action Plan” (BAP) 2007. The BAP expanded the WAMZ programme to include structural measures and benchmarks. Key elements of the structural measures are the liberalization of financial markets and capital accounts, as well as the establishment of a customs union by the WAMZ. Within the context of the BAP, financial integration is to promote “similarity of access, rules and treatment” to all “potential market participants” as the bedrock towards full integration of all financial instruments.

This section reports the status of capital account liberalization in the WAMZ as benchmark of the Banjul Action Plan. The analysis focused on the following:

- i) **General features of the Capital Account Regime** – This deals with issues such as the existence or otherwise of a formal capital account management framework, its objectives, as well as the legislation governing capital account management.
- ii) **Types of controls:** This refers to the instruments or methods adopted by the countries to manage their capital account framework, and could be either direct/administrative or indirect/market based.
- iii) **Direct control measures:** which could be discretionary, may also involve the use of outright prohibitions and quantitative restriction.
- iv) **Indirect/market based measure:** are broadly grouped into Explicit/Implicit

measure taxation and discriminatory exchange rates.

- v) **Capital regime:** This pertains to the inflow or outflow of capital into or out of a country.

With the exception of Liberia and Nigeria, all WAMZ member countries have acceded to the current account obligations of Article VIII of the IMF Articles of agreement. Liberia and Nigeria have acceded to Article XIV in transition to Article VIII. Countries were therefore at varying degrees of capital account liberalization, although they were working assiduously toward full liberalization. There is evidence that all member countries of the WAMZ have implicit capital account management frameworks. For most of the member countries, it is gleaned from the several legislative acts, including banking Acts, Foreign Exchange Acts and legislations on free trade zone. The analyses of the capital account regimes in Member States reveal some commonalities in capital account practices in the WAMZ. For instance, there are no restrictions on capital inflows across the Zone. Apart from Ghana and Liberia, non-residents are allowed to invest in the short end of the local markets. Liberia is the only country in the Zone that restricts residents from issuing securities abroad. Residents in all the countries are allowed to secure commercial and financial credits, as well as guarantees, sureties and financial back up facilities abroad.

3.1 The Gambia

The Gambia has an explicit capital account management framework, with the main

objective of attracting non debt long term funds, mainly for infrastructural development. Investors with short term funds are not restricted, and capital outflows are allowed. The revised regulations for licensing and operation of foreign exchange bureaus (2009) as well as the financial institution and banking Acts (2003 and 2009, respectively) govern the capital account. Residents and non-residents are allowed to sell or buy shares and other securities of a participating nature such as debt instruments, money market instruments, collective investment securities and derivatives. In addition, there are no limits on the securities that institutional investors can issue or purchase or on the portfolio they can invest in.

In terms of inward credit operations, the capital account management framework allows residents to secure commercial and financial credits, as well as guarantees, sureties and financial back up facilities from abroad. Inward direct investment is allowed in all the sectors of the economy, and investors are free to repatriate capital and interest, provided there are transaction trail to back such requests. For outward credit operations on the other hand, residents are permitted to extend commercial and financial credits, as well as guarantees, sureties and financial back up facilities to non-residents, and there are no restrictions on outward direct investment. Residents can invest in real estate abroad, while non-residents are not restricted from engaging in real estate business locally. In addition, non-residents are not restricted from owning real estate in the Gambia. There are no restrictions on opening and operating

foreign currency denominated accounts. However, withdrawal charges apply as a means of limiting its utilization in the domestic economy. Commercial banks can borrow from abroad while residents can hold commercial bank deposits abroad. Commercial banks are also allowed to lend abroad. The frameworks permit inward transfers by immigrants as well as outward transfers by emigrant. Residents can also receive personal capital from non-residents or transfer personal capital to non-residents.

3.2 Ghana

In Ghana the capital account management framework is contained in the various Acts, Foreign Exchange Act of 2006 (Act 723), GIPC⁴ Act of 1994 (Act 478) and the Free Zone Act of 1995. The key objectives of the capital account management framework in Ghana are to attract non debt bearing long term capital inflows and the liberalization of permissible avenues for outward investments. The framework provides for the use of explicit quantitative limits and discretionary approval as direct control measures. In this vein, foreign portfolio investors are only allowed in the debt market if the tenor is at least three years. There is a prescribed minimum capital in resident enterprise, and non-residents can hold leases in real estate up to a maximum of fifty (50) years. Non-residents are allowed to invest in shares and derivatives, but are restricted from money market instruments and short term bonds/debt instruments. Bonds with tenors of three years and above are permissible. The reason behind this is to shield the economy from the effects of hot money, which can be

⁴ GIPC is Ghana Investment Promotion Commission

withdrawn without notice, with dire implications. Resident are however, allowed to issue shares, bonds/debt instruments, collective investment securities and derivatives for sale abroad. Although there are no limits on local portfolio investment, foreign institutional investors are restricted from the short end of the market (securities with tenors below three years).

The provision for inward credit operations is such that residents are allowed to secure commercial and financial credits, as well as guarantees, sureties and financial back up facilities from abroad. Inward direct investment is allowed in all sectors, and there are clearly defined guidelines for the liquidation and repatriation of investment proceeds. These guidelines are spelt out in the GIPC Act, Mineral and Mining Act, and the Free Zone Act. Non-residents can own real estate, but under a maximum of a 50-year lease agreement. The Foreign Exchange Act of 2006 (Act723) permits non-residents to operate local commercial bank accounts while commercial banks too can borrow from abroad, provided that prudential requirements are not breached. The framework also permits inward immigrant transfers. Resident Ghanaian individual investors can invest in shares, bonds/debt instruments, money market instruments, collective investment securities and derivatives abroad. Similarly, non-residents are permitted to issue these same securities for sale in Ghana. For Institutional investors there are neither limits on portfolios invested abroad by residents, nor on the securities issued locally by non-residents. In terms of outward credit operations, residents are allowed to extend commercial and financial credits, as well as guarantees, sureties and financial back up facilities to non-residents.

There are no restrictions on outward direct investment.

Residents can invest in real estate abroad, while non-residents are not restricted from engaging in real estate business. Residents can hold commercial bank deposits abroad, but require the expressed approval of the Bank of Ghana, if it is for official purposes. Commercial banks operating in Ghana are allowed to lend abroad, provided they are designated as fixed authorized dealers. The framework also permits residents to transfer personal capital to non-residents, and provides for emigrant transfers. However, documentary proof of debt is required for emigrants to settle debts abroad. The minimum capital requirement for investment under various laws, non-participation of non-resident at the short end of the securities market, and strict reporting requirements have proved to be effective control measures in the management of capital account in Ghana.

3.3 Guinea

The capital account management framework in Guinea is embedded in the country's central bank Act (Act no L/2005/010/AN). The overriding objective is to attract both short term and long term non debt bearing capital inflows from abroad. The framework provides for the use of explicit quantitative limits and a multiple exchange system regime for different types of transactions as direct and indirect control measures. Individual investors are permitted to invest in shares, bonds/debt instruments, collective investment securities and derivatives issued locally, but residents are restricted from

issuing these same securities abroad. Non-resident institutional investors on the other hand can invest in an infinite number of portfolios and securities in Guinea. As for inward credit operations, residents are at liberty to secure commercial and financial credits, as well as guarantees, sureties and financial back up facilities from abroad. Inward direct investment is permitted for all sectors of the Guinean economy, and there are clearly defined guidelines for the repatriation of capital and interest. Real estate investment is permissible for non-residents, but they are not allowed to operate local commercial bank accounts. However, commercial banks are permitted to borrow from abroad, so long as no prudential requirement is circumvented. Although inward immigrant transfers are permissible, residents are restricted from receiving personal capital from non-residents. The framework permits residents to invest in shares, bonds/debt instruments, money market instruments, collective investment securities and derivative issued abroad, but restricts non-residents from issuing any of these classes of securities locally.

Regarding outward credit operations, residents are not restricted from extending commercial and financial credit, as well as guarantees, sureties and financial back up to non-residents. Outward direct investment is also allowed, with clear guidelines on the liquidation of such investments. Residents can own real estate and operate commercial bank accounts abroad, while non-residents are allowed to engage in real estate business in Guinea. Commercial banks, upon the satisfaction of certain requirements as spelt out by the central bank, can lend abroad. The framework also permits residents to transfer personal capital to non-residents, and it also

provides for emigrant transfers. Emigrant debts abroad can be settled provided there is documentary evidence to that effect.

3.4 Liberia

Liberia's capital account management framework derives from the financial institutions' Act of 1999 and the investment Act of 2010. Inflows of short and long term funds are allowed but there are prudential limits on borrowing in foreign currency. On the other hand, capital and money markets remained rudimentary although the central bank recently introduced treasury bills. Residents are allowed to secure commercial and financial credits, as well as guarantees, sureties and financial back up facilities from abroad. While non-resident institutional investors are not restricted in terms of portfolio investment, the agricultural, mining, services and forestry sectors are the major beneficiaries of inward foreign direct investment. There are clearly defined guidelines for the liquidation and repatriation of these investments as enshrined in the Investment Act of 2010. Non-residents of Negroid descent who are eligible to citizenship are allowed to purchase and own properties, land and real estate in Liberia. To the extent that local banks are able to convince the central bank on the due diligence checks, non-residents are permitted to operate accounts with commercial banks. Commercial banks are not restricted from borrowing abroad to meet liquidity shortfalls. The framework permits inward immigrant transfers and allows residents to benefit from personal capital receipts from non-residents, provided such receipts are not to fund elections or any other politically motivated activities.

In terms of outward credit operations, the framework permits residents to extend commercial and financial credits, as well as guarantees, sureties and financial back up facilities to non-residents, and allows for outward direct investment, with a clear guideline for its liquidation and repatriation of proceeds (Investment Act of 2010). Residents can own real estate abroad, and non-residents of Negroid origin can undertake real estate business locally. Residents are allowed to hold commercial bank deposits abroad, but only for operational purposes like correspondent banking and placements that must be in line with prudential requirements bothering on exposures to foreign exchange risks. Commercial banks are not restricted from lend abroad. Although the Central Bank of Liberia Act of 1999 provides for unrestricted transactions on the current and capital account, the Bank can impose exchange controls for the purpose of shoring up the balance of payments position.

3.5 Nigeria

The capital account management framework in Nigeria is derived from the country's Foreign Exchange Act (No. 17) of 1995. The main objective of the framework is to restrict capital outflows. However, there are no restrictions on long term non debt bearing and short term capital inflows. The framework allows for the use of discretionary approval as a direct control measure. In this vein, applicants are required to submit documentary evidence in respect of the proposed transactions to the authorized dealers for review and approval before remittance is affected. Approval can only be

obtained from the Central Bank of Nigeria. Non-resident individual investors are allowed to invest in shares, bonds/debt instruments, money market instruments, collective investment securities and derivatives floated on the Nigerian market. Although the framework does not expressly permit residents to issue securities abroad, there are instances where shares of resident enterprises were floated on foreign markets. Such transactions will require the use of investment bankers that consummate the transactions using sub-brokers in the listing country. Non-resident Institutional investors are limited in terms of the volume of securities (25 % and 30 % of amount on offer for treasury bills and government bonds, respectively) but not on the portfolios they can invest in.

Inward direct investment (with clear guidelines on its liquidation and repatriation of capital and interest as provided for in the Foreign Exchange Act and the Nigeria Investment Promotion Act of 1995) is allowed in the oil and gas, banking, communication, building and construction sectors. Residents are also permitted to secure commercial and financial credits, as well as guarantees, sureties and financial back up facilities from abroad. Non-residents can own real estate but are restricted from operating accounts in commercial banks in Nigeria. Commercial banks are however, allowed to borrow abroad provided there is no breach of prudential requirements. Inward immigrant transfers are permitted and residents can receive personal capital from non-residents, but only in the form of home remittances, charity funds and grants/gifts, and provided they can show proof that such transfer is not an attempt to launder money and finance terrorism. While the framework

permits residents to purchase securities abroad, it is silent on non-residents' eligibility to issue securities on the Nigerian market. However, there have been instances where foreign owned enterprises have floated shares on the floor of the Nigerian Stock Exchange. Outward direct investment and extension of commercial and financial credits to non-residents are prohibited. However, residents are allowed to issue guarantees, sureties and financial back up facilities in favour of non-residents. Although residents are restricted from owning real estate abroad, non-residents can engage in real estate business locally, provided they incorporate a company and obtain all necessary approval from the relevant government agency. Residents are prohibited from holding accounts in commercial banks abroad and transferring personal capital to non-residents. Outward emigrant transfers in the form of personal home remittances for expatriates are permitted, but emigrants are not allowed to settle debts incurred abroad. Commercial banks are restricted from lending abroad. In terms of limits on securities and port folios, the framework does restrict institutional investors.

3.6 Sierra Leone

The capital account management framework in Sierra Leone is contained in the Exchange Control Act of 1965. The main objectives of the framework include, attracting long term non debt bearing capital inflow, restricting capital outflows and avoiding excessive borrowing in foreign currency.

There are generally no restrictions on capital inflows. Non-resident individual investors are allowed to invest in shares and bonds/debt instruments, provided the funds pass through the banking system. Although non-residents

are restricted from money market instruments, compliance is hard to monitor as the source of funds invested in these securities are not completely traceable. The regulation is silent on collective investment securities and derivatives since they are not common. On the other hand, residents can issue shares and bonds abroad, provided the proceeds from the shares are channeled through the banking system and the bonds are for financing locally incorporated companies. Residents are also allowed to issue money market instruments abroad, on the condition that commercial banks seek and obtain Bank of Sierra Leone approval for them. Non-resident institutional investors are restricted from investing in money market instruments.

Inward direct investment for the development of the mining, agriculture, banking, telecoms and fisheries sectors is permissible, albeit, without any guidelines for the liquidation and repatriation of the proceeds (and capital) from such investments. Residents can secure commercial and financial credits, as well as guarantees, sureties and financial back up facilities from abroad. However, such guarantees must be denominated in the local currency. Non-residents can own real estate and operate commercial bank accounts, subject to satisfying the required documentation. For commercial banks to borrow abroad, the loans must be fully covered by external collateral acceptable to the lending institution. Residents can receive personal capital from non-residents and immigrant transfers are permissible. In terms of capital outflow, non-residents require the approval of the Bank of Sierra Leone to issue shares, bonds, money market instruments (mainly for other WAMZ member countries), collective investment securities and derivatives in Sierra Leone. Residents, on the

other hand, are allowed to invest in securities abroad, but must obtain approval from the Bank of Sierra Leone. Limits are placed on non-resident institutional investors, but only in terms of the securities they can invest in, and not on the portfolios. Outwards direct investment is prohibited and residents are not allowed to own real estate abroad. However, non-residents can carry on real estate business in the country. Additionally, residents cannot hold deposits in commercial banks abroad. Under special circumstances, commercial banks can hold deposits in foreign banks but are restricted from lending

abroad. Emigrant transfers in respect of payments for international transactions are allowed.

3.1.1 Benchmarking Capital Account Openness in Member Countries of the WAMZ: A Gap Analysis

Given that WAMZ countries are committed to full capital account liberalization as contained in the BAP, Table 3 shows the level of compliance with the benchmark (The Gambia has already liberalized).

Table 3: GAP ANALYSIS OF CAPITAL ACCOUNT PRACTICES IN MEMBER STATES OF THE WAMZ

Restrictions on Capital Transactions	GM	GH	GUI	LIB	NIG	SLE	No of Countries with restrictions
Use of Control Instruments	No	Yes	Yes	Yes	Yes	Yes	5
Money Market transactions	No	Yes	Yes	N/A	No	Yes	3
Capital Market transactions	No	No	N/A	N/A	No	No	Nil
Collective Investment Securities	No	No	N/A	N/A	No	N/A	Nil
Derivatives and other instruments	N/A	N/A	N/A	N/A	N/A	N/A	Nil
Commercial Credits	No	No	Yes	No	Yes	No	2
Financial Credits	No	No	Yes	No	Yes	No	2
Guaranties, Sureties and Financial back up facilities	No	No	Yes	No	No	No	1
Direct Investment	No	No	No	No	Yes	Yes	2
Liquidation of Direct Investment	No	No	No	No	No	Yes	1
Real Estate transactions	No	No	No	Yes	Yes	Yes	3
Personal Capital movements	No	No	Yes	No	Yes	No	2
Commercial banks and other Credit Institutions	No	No	Yes	No	Yes	Yes	3
Institutional Investors	No	Yes	No	No	Yes	Yes	3

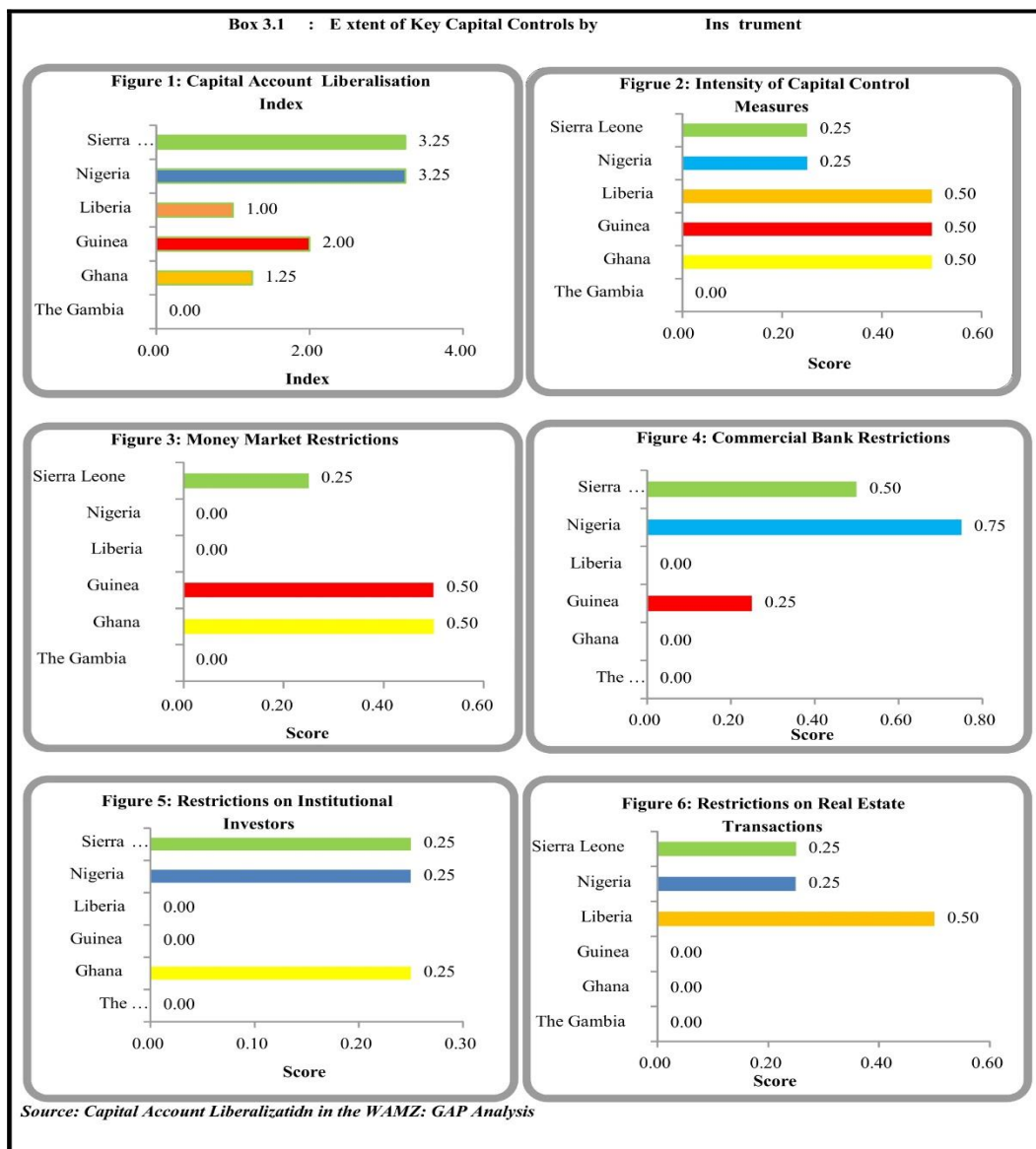
Source: Questionnaire responses

Key: GM- The Gambia; GH – Ghana; GUI – Guinea; LIB – Liberia; NIG – Nigeria; SLE – Sierra Leone

Yes – Restrictions exist; No – Restrictions do not exist; N/A – Not applicable

Whereas capital inflows, especially long term non-debt bearing capital are generally unrestricted within the WAMZ member states, various restrictions on outflows exist. Table 3, which was constructed from items in the various themes mentioned earlier, illustrates the extent of restrictions on capital

account practices in member countries of the WAMZ. The Table reveals that the capital accounts framework in The Gambia is devoid of any restrictions, and thus serving ideal benchmark for full capital account liberalization.



Within the framework of capital account practices in member countries, the use of direct and/or indirect controls was widespread, with all the countries, except the Gambia, deploying such tools. Table 3 shows that Ghana, Guinea, and Sierra Leone have restrictions on money market instruments. In terms of real estate transactions, restrictions could be found in Liberia, Nigeria, and Sierra Leone. For provisions relating to commercial banking and institutional investors, controls could be found in Guinea, Nigeria, and Sierra Leone (see Box 3.1). Guinea and Nigeria had restrictions bordering on commercial and financial credits as well as personal capital movements. In particular, Guinea placed restrictions on provisions governing the issuance or acceptance of guarantees, sureties and financial back up facilities. While FDIs are allowed there are no guidelines for the liquidation of direct investments in Sierra Leone. Overall, capital market transactions, including the purchase/sale of shares/equities, long term bonds/debt instruments, long term collective investment securities as well as derivatives were unrestricted in all member countries.

Given that WAMZ countries were committed to full capital account liberalization as stipulated in the BAP, it will be crucial for Ghana, Guinea, Liberia, Nigeria and Sierra Leone to adopt an integrated approach to liberalization. This essentially involves two stages:

Stage 1 (2013 – 2014)

1. Since capital account liberalization is best undertaken in an atmosphere of sound and sustainable macroeconomic policies, there is need to continue to strengthen and reinforce macroeconomic policies in member

countries. In particular, monetary policies should target reducing inflation to single digit and maintaining exchange rate stability while fiscal policies should be rationalized to cut budget deficits, enhance revenue mobilisation and make public debts sustainable.

2. Undertake and prioritize the implementation of financial sector reforms to support and reinforce macroeconomic stability. Financial sector reforms should be focused on improving the depth and vibrancy of markets. In addition, the reforms should be mutually reinforcing and operationally linked and implemented holistically. This will typically include:

- a. Enhancing the efficiency and capacity of banks by strengthening risk management, corporate governance, and capitalization;
- b. Expanding access to finance by supporting the development of microfinance, payments systems, and financial innovation;
- c. Deepening money and capital markets through for instance promoting secondary market activities, interbank markets, market makers as well as developing and issuing debt securities; and
- d. Increasing insurance penetration by strengthening insurance regulation and capitalisation as well as raising perception about insurance through effective claims processing.

Strengthen domestic prudential regulations to compliment financial sector reforms. In

essence, this will require strengthening compliance with international standards such as the Basel Core Principles (BCPs),

International Financial Reporting Standards (IFRS), FATF 40+9 Recommendations, and Risk-based Supervision, among others.

Box 3.2: Review of Key Legal Instruments in the WAMZ

The liberalization of capital accounts will require the review of some legal instruments:

Ghana

- a. Foreign Exchange Act
- b. Central Bank Act
- c. GIPC Act

Guinea

- a. Central Bank Act
- b. Foreign Exchange Act
- c. Banking Act

Liberia

- a. Financial Institutions' Act
- b. Central Bank Act
- c. Foreign Exchange Act
- d. Investment Act

Nigeria

- a. Foreign Exchange Act
- b. Investment Promotion Act
- c. Central Bank Act

Sierra Leone

- a. Exchange Control Act
- b. Central Bank Act

Source: WAMI Staff

Stage 2 (one to two years)

1. Liberalize capital flows by instruments and/or sectors but sequenced to take into account concomitant risks — in general, long-term and non-debt creating flows (especially FDI) should be liberalized before short-term and debt-creating flows. This encompasses the review of various legislation restriction capital flows (see Box 4.2).

2. Emphasis should be placed on internal liberalization within and between WAMZ Member States including the

introduction of appropriate conditions to attract external capital flows.

3. The pace of liberalisation should take into account the conditions in the real sector. This means Member States should identify sectors that are underdeveloped and liberalise them early or identify sectors that could be adversely affected by liberalisation and put in place policies to mitigate those effects.

4. In view of the weakness of some control measures such as the limitation on

real estate in Member States, it is vital to eliminate restrictions on such sectors where the enforcement of capital controls is difficult.

5. The arrangements for policy transparency and data disclosure should be adapted to support capital account opening. This implies Member States should strengthen macroeconomic data management

and gathering by improving its scope, accuracy and timing.

Overall, the full capital account liberalization with WAMZ should follow the gradualist approach, i.e, the phasing and sequencing of capital account liberalization while having in place a robust “capital account management framework that emphasizes macroeconomic and financial stability.

4.0 BANKING SUPERVISION AND REGULATION

Banking supervision and regulation in the Zone continued to be centered on strengthening compliance with the revised 29 Basel Core Principles (BCPs)⁵ and migration to Basel II and III. In addition, while some countries (Ghana and Sierra Leone) have fully implemented the International Financial Report Standards (IFRS), others are at various stages of migration to the Standard. The College of Supervisors of the WAMZ continued to provide the platform for enhancing financial stability and collaboration among regulators in the zone including the harmonisation of banking supervisory processes. The automation of processes for bank examination and supervision remains a top priority for most Member States. The rendition of prudential returns of banks is done electronically in

most Member States. Ghana and Nigeria use Electronic Financial Analysis and Surveillance System (e-FASS) for off-site surveillance while The Gambia, Liberia and Sierra Leone employ the Valtech Regulatory and Compliance System (V-RegCoSS). Plans were under to implement the System in Guinea. Over 30 Nigerian bank subsidiaries have been jointly examined by bank supervisors from the Central Bank of Nigeria and the other WAMZ countries since the commencement of the programme in 2011. The CBN also solely examined ten subsidiaries and had signed a cooperation agreement (Memorandum of Understanding (MoU)) with Commission Bancaire de l'UMOA, while the other countries in the Zone were in the process of doing same

Box 4.1: Enhancing Cross-border Supervision of Banks: The CSWAMZ

Going by the experience from the past and current financial crises, it has become increasingly obvious that financial instability can occur even in an environment where monetary policy has achieved low and stable inflation. The implication is that sound monetary policy is a necessary though not sufficient condition to guarantee financial stability and sustainable economic growth. Safeguarding the stability of banks and other financial intermediaries has therefore been given greater emphasis by regulators especially in the WAMZ where the banking system dominates the financial system. In July 2010, the Committee of Governors of the West African Monetary Zone (WAMZ) established the College of Supervisors of the WAMZ (CSWAMZ). The decision to establish the College was to enhance cooperation, information sharing and coordination among others, between bank supervisors in the WAMZ, consistent with international efforts at improving global financial stability. At the WAMZ level, the College of Supervisors provides the platform for members to promote financial stability in the zone through information sharing, cooperation and collaboration.

⁵ Except for Sierra Leone, the assessment of BCPs was in terms of the old 25 principles.

With respect to compliance to Basel Core Principles, **The Gambia** is fully compliant with fifteen (15), largely compliant with ten (10), materially non-compliant with one (1) and four (4) of the principles are not applicable. However, the authorities were cautious of the transition to Basel II, citing cost implications as a cause for concern, but efforts are being made to migrate progressively from a hybrid (compliance and risk-based) to a fully-fledged risk-based supervisory framework. In addition, the Central Bank of The Gambia (CBG) was reviewing the Sheriffs and Mortgages Act in order to minimize the cost, uncertainty, and complexity of dealing with NPLs. The Bill, which will be submitted to the National Assembly as an amendment to the Banking Act 2009 is expected to tighten loan classification and provisioning rules by introducing a new category of “special mention loans” capturing loans which are 30-90 days past due with a provisioning rate of 5 percent. Plans were on the way to set up a Collateral Registry while the CBG has directed all commercial banks to prepare financial statements in accordance with IFRS.

Ghana was currently compliant with 8 BCPs, largely compliant with 16, materially non-compliant with 4 and non-compliant with 1. The authorities were preparing for to Basel II with the full application of RBS since 2007. Most banks established risk management departments during the review period. In addition, all the banks were applying the IFRS. One credit reference bureau was licensed during the review period bringing the number of credit bureaus to three. The BOG was also working on feasibility of instituting deposit insurance. The Bank also commenced the review of the Bank of Ghana

(BoG) and Foreign Exchange Acts. In addition, the BoG finalized and issued several guidelines to the banking industry in a bid to strengthen financial stability and improve the financial infrastructure. In order to reinforce its policy stance, the Bank revised the limits for net open position (NOP) in foreign currency to 10.0 percent for single currency and 20.0 percent aggregate position. **Guinea** has complied with 7 principles, materially in conformity with 18, not in compliance with 1, while 4 were deemed not applicable. The principle with which the country is not in conformity relates to the lack of provisions in the banking legislation on money-laundering. The Central Bank of Guinea was working with Inter-Governmental Action Group Against Money laundering (GIABA) to strengthen compliance with financial action task force (FATF) recommendations. Towards this end, a revised legislation on money-laundering was being prepared. Similarly, the country has finalized legislation on lease financing.

The **Central Bank of Liberia (CBL)** made significant progress with the implementation of risk-based supervision during the review period. In this regard, the Bank conducted a review of the risk management programme of commercial banks and issued out risk management and internal control guidelines to guide commercial banks in developing their own risk management programmes. Furthermore, an institutional profile was developed for each bank, focusing on corporate profile, risk management system, risk profile and other regulatory and supervisory issues. The adoption of risk-based supervision (RBS) prepared the CBL for the transition to Basel II while enhancing its supervisory regime, placing the Bank at par with regional and international standards.

To automate and modernize its regulatory and supervisory processes the Bank was undertaking plans for the acquisition of Valtech Regulatory Compliance & Surveillance Software (V-RegCoSS). The CBL also introduced mobile money to promote financial access and facilitate small scale payments. In addition, corporate governance and audit regulations were amended to enhance risk management in banks and provide a general framework for the conduct of external audit of financial institutions.

The IMF/World Bank Financial Sector Assessment Programme (FSAP) which was carried out in 2012 indicated that bank supervision in **Nigeria** improved markedly since the 2008 financial crisis. This reflected better onsite and offsite practices and higher standards of corporate governance. Compliance with the BCPs also improved during the review period. In addition, the CBN carried out follow-up visits to confirm the implementation of the plans on IFRS submitted by the banks. In terms of compliance with the BCPs, Nigeria was fully compliant with 1, largely compliant with 18 and materially non-compliant with 6. Regarding the Implementation of Basel II, the CBN conducted a parallel run and issued new capital adequacy computation templates to banks. The new templates were being used in parallel with Basel I templates for six months. Deposit money banks are expected to submit Internal Capital Adequacy Assessment Process (ICAAP) documents by end-April 2014. To further streamline the implementation of IFRS, the Financial Reporting Council of Nigeria (FRC) issued

guidance on mandatory exceptions and optional exemptions for first-time adoption. The CBN also adopted a risk-based supervision methodology for the examination of the MFBs and extended its funding of the Microfinance Certification Programme (MCP) by one year, to December 31, 2013.

The **Bank of Sierra Leone (BSL)** was largely compliant with 25 of the newly revised 29 Basel Core Principles and materially non-compliant with 4. The Bank was also in the process of engaging a Consultant to help with its planned migration from compliance-based supervision to risk-based supervision. However, the BSL was yet to fully comply with Basel II and III. During the review period, the BSL approved the implementation of the International Financial Reporting Standards (IFRS) for deposit banks in accordance with the Banking Act (2011). In addition to strengthen supervision and regulation of the banks, new prudential guidelines and a schedule of penalties were issued to deposit money banks in line with the Banking Act (2011). Other objectives pursued during the year included the strengthening the operations of the Credit Reference Bureau and implementation of the Anti-Money Laundering and Countering the Financing of Terrorism Act. Furthermore, the Bank acquired the Valtech Regulatory Compliance and Surveillance System (vRegCoSS) with a US\$2 million grant from the International Fund for Agricultural Development (IFAD). Given the need to deepen access to finance, the Bank endorsed mobile telephone banking. It also undertook financial literacy campaigns in collaboration with other financial sector actors.

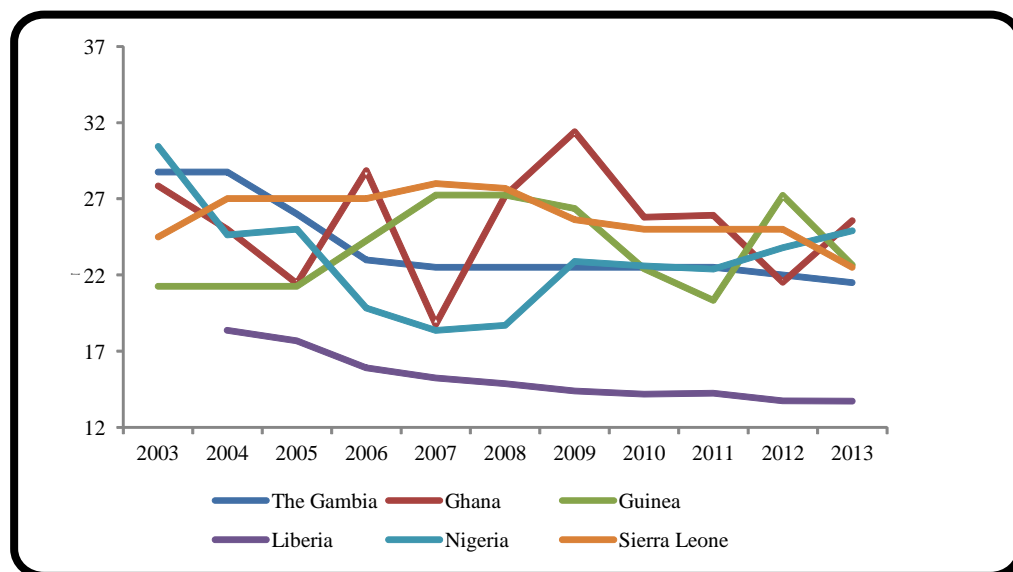
5.0 THE STATE OF FINANCIAL MARKETS INTEGRATION IN THE WEST AFRICAN MONETARY ZONE (WAMZ)

This section evaluates the degree of integration in the WAMZ financial system from the perspective of the law of one price for financial assets in the zone. This is achieved by way of cross-country convergence/divergence in lending and savings rates, as well the yields from treasury

instruments and the pooling of resources in the banking sector. It also looks at institutional and structural arrangements that have been put in place to facilitate the integration of the various sectors of the financial system in the WAMZ.

5.1 Cross-Country Pricing of Financial Assets/Interest Rate (Convergence/Divergence)

Figure 4: Lending Rates



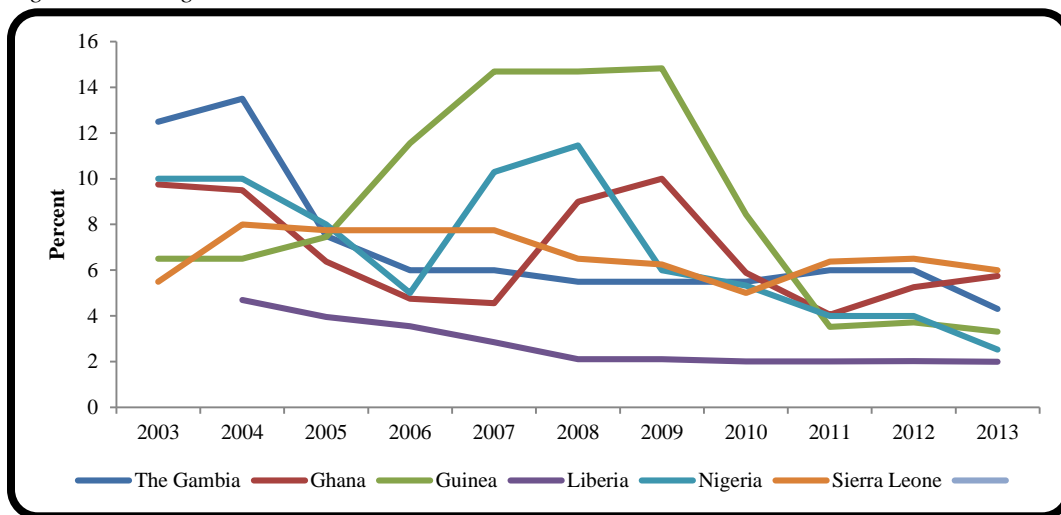
The average lending rates typically reflects the cost of doing business. Although the rates vary across member countries of the WAMZ, they have remained high, due mainly to the existence of structural bottlenecks. As revealed in Figure 4, the lending rates exhibited a mixed trend across member countries during 2003-2013, with the exception of Liberia, where it has generally trended downwards. At end-December 2005,

there was minimal evidence of convergence, with the rates converging towards the 19-25 percent range in The Gambia, Ghana and Guinea. The number of countries that showed evidence of convergence reduced to two in 2007 (Ghana and Nigeria at about 19 percent), before rising to three in 2009 (Ghana, Nigeria and Sierra Leone at between 23-25 percent). In the current assessment period, three countries, namely The Gambia,

Guinea and Sierra Leone showed some evidence of convergence, following a fall in rates in Guinea and Sierra Leone. Rates

increased in Ghana and Nigeria, whilst remaining relatively unchanged in Liberia.

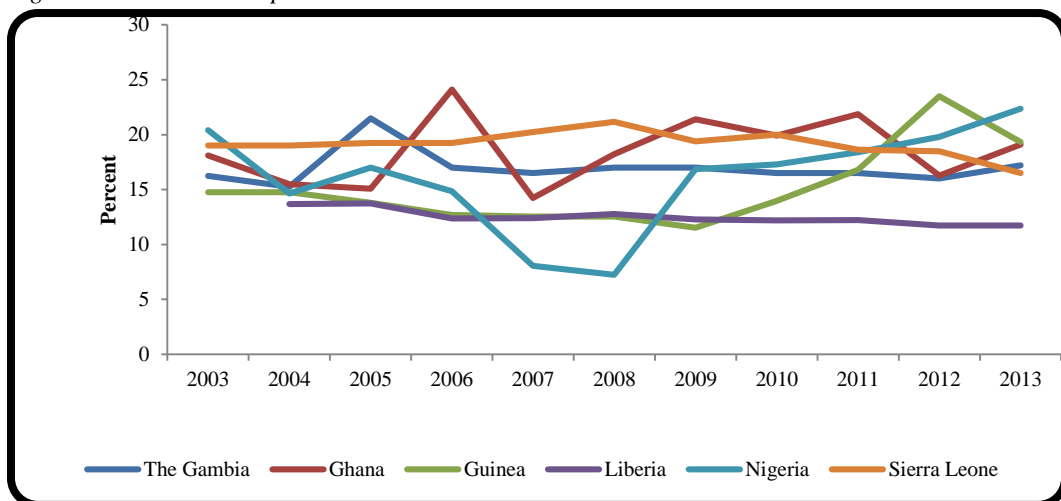
Figure 5: Savings Rates



All things being equal, the savings rate is a measure of the propensity to save, and by extension, a determination of the level of availability of funds for investment purposes. Previous assessment periods showed better

evidence of convergence (three countries in 2005 and 2007 and four countries in 2009), compared to two countries in the current review period.

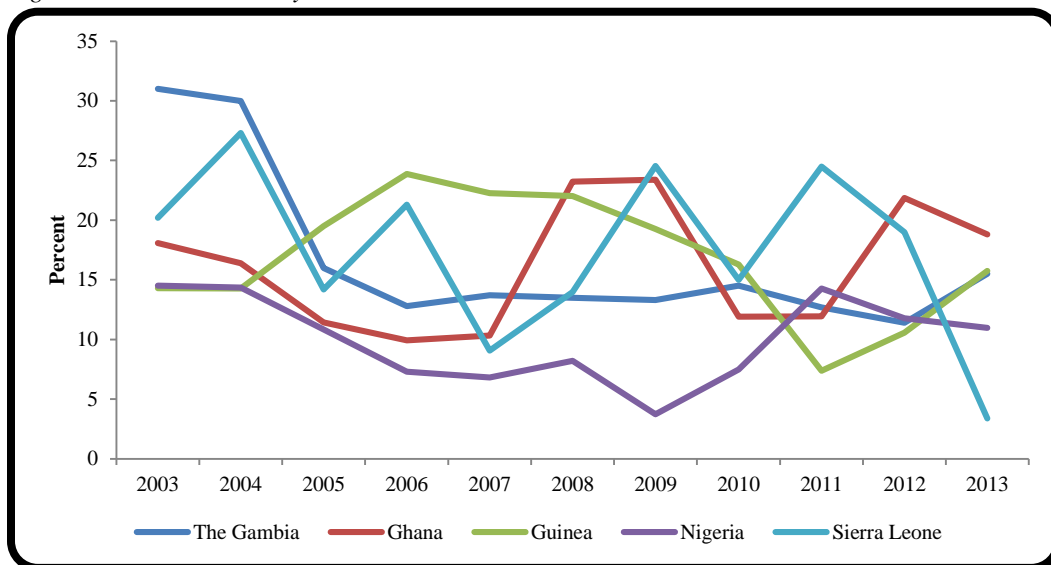
Figure 6: Interest Rate Spread



Interest rate spread in member countries have mirrored the movements in lending and savings rates, increasing and decreasing with upward/downward movements in lending and savings rates respectively (Figure 6).

Evidence of convergence is at best, minimal. The Gambia, Ghana and Guinea showed some evidence of convergence in the current assessment period.

Figure 7: Yield on Treasury Bills



Liberia was excluded from this measure of convergence since the country only recently introduced treasury instruments. Evidence of convergence, which had been almost non-existent in the previous assessment period became strong at end-December, 2012, with yields becoming almost the same in three member countries, with that of a fourth countries trending towards the convergence point. However, the number of countries showing this trend fell to three in 2013.

5.2 Pooling of Resources in the Banking Sector

One of the immediate benefits of cross-border banking or banking integration is the development of stronger credit institutions

that are able to offer a wider and more complex array of financial products and services at competitive prices. This is because the establishment of foreign banks in a local jurisdiction is expected to in-stigate competition in the existing local banks, causing them to expand and gain more market share. This is expected to bring about a reduction in the cost of funds through convergence of interest rates as well as improvements in financial inclusion through increased branch network, better and cheaper access to credit, enhancements in alternative banking outlets like Automated Teller Machines (ATMs), mobile, as well as internet banking platforms. However, the analysis of interest rates in this section indicates that the cost of borrowing was still high and disperse across Member States

indicating minimal convergence of rates. This implies that despite the improvements in terms of the availability of new and varied financial products and increased branch networking access to, and affordability of

credit continue to remain a challenge largely on account of weak financial policy harmonisation and macroeconomic challenges in Member States.

6.0 INSTITUTIONAL ARRANGEMENTS FOR FINANCIAL INTEGRATION IN THE WAMZ

6.1 Capital Markets Integration in West Africa

The process for integrating capital markets in West Africa started in 2010 with the signing of a Memorandum of Understanding (MOU) by the various Exchanges and regulatory authorities in the region to deepen cooperation, promote mutual assistance and facilitate the exchange of information and consultation among countries. However, the process was initially fraught with challenges until 2013 when the West African Capital Market Integration Council (WACMIC) was inaugurated as the governing body for the integration of capital markets in West Africa as part with the regional integration programme. WACMIC comprises the Heads of the Stock Exchanges and Securities and Exchange Commissions in the West African Economic and Monetary Union (UEMOA Zone), Ghana, Nigeria and Sierra Leone was established in 2013, to spearhead the integration of capital markets in the region. The Council's activities are backed by the Charter for the Integration of Capital Markets in West Africa and guided by a Technical Committee. Membership of the Technical Committee is drawn from the participating Stock Exchanges and other Statutory Regulators. In order to facilitate its functions, the Technical Committee is broken down into two Technical Sub-Committees; namely: Depository, Trading, Clearing and Settlement (DTCS) and Legal and Regulatory (LR). The Technical Committee and Council have adopted a three-phased approach to capital market integration.

The main objective of the Council is to establish a harmonised regulatory

environment for the issuance and trading of financial securities across the Economic Community of West African States (ECOWAS). It is tasked with designing the policy framework and managing the implementation of the processes that will facilitates the creation of an integrated capital market in West Africa. Specifically, the Council is to:

- Supervise the capital market integration programs
- Set up standards and validate all works done by its Technical Committees
- Monitor and assess the state of preparedness of the Member States in the integration process
- Source funds and other resources for the implementation of capital market integration
- Monitor standards and compliance post-integration

6.1.1 Why Capital Market Integration?

The ECOWAS region has a strategic geographic footprint in Africa because of its large and diverse population of over 290 million, translating into a consumer base with significant domestic savings and investment potential as well as increased opportunities for risk diversification. As a result, the integration of West Africa's capital markets will speed up the development of our various

domestic financial systems, promoting increased competition and innovation. In addition, successful capital market integration will provide more choices of financial products provided to regional and foreign investors; and increase the sub-regions integration with the global economy. The harmonization of regulations and trading practices that would accompany any regionalization of exchanges could deepen regional integration more broadly in such areas as taxation, accounting standards, corporate governance, and legal practices. As regionalization and capital market development advances, establishing stock market segments across a region, specializing in different industry sectors or types of share issues, might foster further capital market development by improving efficiency.

Ultimately, capital market integration in West Africa will result in more effective price discovery, enabling Stock Markets to become vibrant by attracting investment flows. Furthermore, the ease of capital movement within the region will create flexibility for issuers looking to raise capital and investors looking to invest across member states.

6.1.2 Roadmap of Capital Market Integration in West Africa

The capital market integration programme is organized in three phases, namely: Sponsored Access (Phase 1), Qualified West African Broker (QWAB) (Phase 2) and Fully Integrated West

African Securities Market (WASM) (Phase 3).

Phase 1: Sponsored Access

Brokers within ECOWAS can trade securities and stele in markets other than their home country, through local brokers in other jurisdictions. To facilitate this process, Sponsored Access rules and related agreements are executed among Member Exchanges. The Sponsored Access rules and agreements are available on the websites of participating markets. With signed MOU (recognised by regulators in the region) in place, WACMI dealing members (brokers-dealers) will be able to trade among themselves via sponsored access.

Phase 2: Qualified West African Broker (QWAB)

This approach is an improvement on the Sponsored Access, as it allows the licensed foreign dealing member/broker to access the local market directly. The conditions are however more stringent than those of the Sponsored Access Phase, especially with respect to risk management. The licensed foreign dealing member/broker assumes the same status as the local counterpart in allowable areas⁶ of the market if they qualify for and receive a common passport that is mutually recognised by Member Exchanges. For this Phase to become effective, listing requirements and governance structures in the participating markets would have to be harmonized, training and certification

⁶This refers to the types of transactions that QWABs are allowed to operate in markets other than their local.

standardized and a common passport introduced. The commencement of this phase would depend on the success of the first phase.

Phase 3: Fully Integrated West African Securities Market (WASM)

At this stage, all WACMI member exchanges will be linked in a virtual West African Securities Markets (WASM) that mirrors all participating exchanges. QWABs will have access to listed

securities and related market information to enable them execute transactions across ECOWAS. Issuers will also be able to raise capital across the region. However, orders would be routed to, and settled in the market for listing through an order routing technology. Although securities on the WASM would be quoted in USD dollars, settlement would be in the local currency of the market of listing. A virtual International Central Securities Depository (ICSD) would complement the WASM in securities clearing.

6.2 Banking Sector Integration in the WAMZ

In order to facilitate the integration of the banking sector in the WAMZ, the College of Supervisors of the West African Monetary Zone (CSWAMZ) was set up in 2010. This College, which is made up of the directors of banking supervision of the WAMZ Central Banks, meets every quarter to assess the performance of banks in the Zone, with a view to ensuring stability and soundness in the banking landscape. The College presents detailed progress report of its activities including its achievements, challenges and recommendations to the Committee of Governors during the WAMZ statutory meetings.

Some of the major achievements of the College to date include:

- Formalization of road maps for the implementation of Risk Based Supervision (RBS), International Financial Reporting Standards (IFRS) and Basel II and eFASS/VRegCoSS in member states

- Strengthening of corporate governance standards for banks in member states
- Enhanced collaboration between commercial/deposit money banks in the Zone
- Strengthening capacity of bank examiners in the Zone through the execution of courses for banking supervisors by WAIFEM
- Harmonization of microfinance framework
- Development of a proposed information sharing framework.
- Joint examination of subsidiaries of Nigerian banks within the Zone
- Publication of the Financial Stability Report for the Zone

The Financial Stability Report provides relevant and significant insights about the health of the financial system as well as efforts being undertaken by member states to ensure a sound financial system.

6.3 Insurance Sector Integration in the WAMZ

The Inaugural Stakeholders' meeting for the integration of the insurance sector in the WAMZ was held at the ECOWAS Commission in Abuja, Nigeria, from July 30-31, 2013. This meeting, which was the result of the collaboration between the West African Monetary Institute (WAMI), and West African Insurance Companies Association (WAICA)⁷, was jointly hosted and sponsored by the ECOWAS Commission and the National Insurance Commission of Nigeria.

The meeting, which was aimed at jumpstarting the process of insurance sector integration in the WAMZ, took the form of paper presentations and panel discussions, and provided participants with the opportunity to take stock of previous efforts at WAMZ insurance sector integration, milestones set and achieved. The meeting also gave a synopsis of insurance regulation and operation in five member states of the WAMZ, as well as the UEMOA zone. Most importantly, participants got a clear and implementable roadmap for insurance sector integration in the WAMZ.

Insurance regulators and practitioners in the WAMZ member states, Coordinators of the ECOWAS Brown Card Scheme, the ECOWAS Commission, WAMI and WAICA, as well as the insurance regulator from Cote D'Ivoire were in attendance. Mali attended as an observer.

At the end of the meeting, delegates made the following recommendations:

- Streamline insurance integration efforts in the WAMZ
- Adopt Guinea as a member of WAICA
- Constitute the West African Insurance Sector Integration Council (WAISIC) to oversee the integration of the insurance sector in member countries of the WAMZ. The WAISIC to be made up of the Heads of National Insurance Regulation in member countries and the CEOs of Insurance Associations in member countries. The CEO of the ECOWAS Brown Card Scheme and the Private Sector Department of the ECOWAS Commission, WAMI and WAICA are observer members.
- Constitute a Technical Committee (TC), to advise the WAISIC on the harmonization of the rules and regulatory frameworks, harmonization of operational processes, and the creation of a common platform for cross border insurance operations in the WAMZ
- The Technical Committee shall comprise of representatives from Insurance Commissions, National Insurance Associations, National Insurance Brokers Association, ECOWAS Brown Card Scheme, Central Banks, ECOWAS, WAMI, WAICA, UEMOA.

Select Technical Committee meetings were held in Banjul, The Gambia, from September 30-November 1, 2013, and Monrovia, Liberia, from December 16. The meeting reviewed the draft Charter for the WAISIC,

⁷ Member States in The Gambia, Ghana, Liberia, Nigeria and Sierra Leone

as well as the Terms of Reference for the Technical Committee. The inaugural Technical Committee meeting is scheduled to hold in Monrovia, Liberia, from December 9-10. The objective of that meeting is to

consider and adopt the Charter and TOR, following which the process of integrating the insurance sector in the WAMZ would commence.

7.0 OBSTACLES TO FINANCIAL INTEGRATION IN THE WAMZ

Despite potential for financial market integration in West Africa, key bottlenecks exist. These under-mentioned discussions highlight the main obstacles to the creation of a single market in financial services.

7.1 Small Financial Systems Dominated by Banks

Financial systems of Member States are generally small relative to the size of their Gross Domestic Product (GDP) and are dominated by the banking sector. The banking sector accounts for over 75 percent of total financial sector assets. Non-bank financial institutions such as microfinance institutions, insurance companies, finance houses and collective investment schemes among others, have remained small players in the financial sector. In addition, banking has largely followed the traditional model of bank branch expansion and introduction automated teller machines (ATMs) which are accessible to only a small fraction of the population. Moreover, infrastructure bottlenecks such as weak information communication technology (ICT) across the sub-region, inhibits financial innovation and access to finance.

7.2 Low Levels of Access to Formal Financial Services

The level of access to formal financial services remains low across WAMZ countries. Economic agents, such as small and medium scale enterprises and rural population are more affected by the constraints on access than others. In particular, overall bank branch penetration

remains low (an average of 0.3 per 1000 inhabitant), underpinning the low level of financial inclusion. The economies of Member States are also characterized by low level of private sector credit as well as sluggish growth in bank branches (as discussed earlier) on account of the structural bottlenecks such as poor information technology infrastructure.

7.3 Limited Development of Securities Markets and Institutional Investors

The level of development of capital markets varies greatly among Member States. Only Ghana and Nigeria have vibrant stock exchanges. The Gambia, Guinea and Liberia do not have stock markets while only one company has been listed on the Sierra Leone Stock Exchange since 2007 when it commenced operations. In addition, efforts to integrate the stock markets in the Zone are at early stages and would require significant investment. On the other hand, while pension funds are steadily emerging and making remarkable strides in member countries, insurance penetration remains very low (less than 1 percent in all Member States). Moreover, capital market regulation vary across countries with very limited harmonisation.

7.4 Disjointed financial market regulation and supervision

There are relative differences in the economic, legal and regulatory policies hindering cross-border capital market transactions. In particular, the level of compliance with international regulatory

standards such as Basel Core Principles, Basel II and III and International Financial Reporting Standards (IFRS) among others varies widely across Member States. Furthermore, minimum capital requirements for banks and other financial institutions vary significantly across the sub-region creating the potential for regulatory arbitrage. Also, prevailing capital account restrictions represent a significant barrier to the cross-border flow of funds and the prospective common financial market. Moreover, there is limited cross-border trade in insurance services on account of the fragmented legal framework particularly in the WAMZ (UEMOA have a common passport for insurance companies and thus ahead in this regard).

7.5 Weak Financial Architecture for cross-border supervision of Banking Groups

The widespread presence of Nigerian Bank subsidiaries is prominent feature of the financial system across Member States. Currently, seven Nigerian banks have 31 subsidiaries while Ecobank of Togo has subsidiaries in all WAMZ Member States. This phenomenon underscores the need for a consolidated approach to supervision of Banking Groups. Moreover, inadequate supervision and regulation of large and substantially interconnected financial institutions on a consolidated basis could precipitate contagion and result in financial crisis.

7.6 High Cost of Funds

While competition in the financial sector is increasing, lending rates remain high across Member States on account of historically high inflation and high credit risks triggered by rising loan defaults. The spread between lending and deposit rates remain significantly high in all countries, undermining the intermediation of funds.

7.7 Capital Account Restrictions

The imposition of outright restrictions on foreign ownership of domestic equities in some Member States of the WAMZ is another barrier to full integration financial markets in West Africa. In some countries, there are restrictions on individual and cumulative limits on foreign ownership of domestic equities, as well as restrictions on domestic investors' ownership of international equities. Furthermore, controls on capital mobility such as limits on fund transfers and exchange control regulations constitute a significant barrier to cross-border flow of funds.

7.8 Other Obstacles

Other obstacles include: absence of legislation on cross-border information sharing, weak payments system infrastructure, limited private credit reference bureaux, credit rating agencies, collateral registries and deposit insurance schemes.

8.0 FRAMEWORK FOR FINANCIAL INTEGRATION IN THE WAMZ

The central objective of the WAMZ programme on financial integration is *‘to work towards financial markets integration while undertaking the technical preparations for the introduction of the WAMZ Eco currency’*. Given the divergence in the state of financial sector development in the WAMZ member countries, it is germane to ensure that the financial sector is adequately prepared to guarantee financial inclusiveness that would facilitate a seamless introduction of a single currency as well as the implementation of monetary policy by a common central bank (West African Central Bank). From the foregoing, it is evident that the integration strategy/framework that should be adopted by the WAMZ must be the

type that develops and integrates all sectors of the WAMZ financial landscape in an incremental and simultaneous manner. Unfortunately, while a lot has been done by the West African Monetary Institute (WAMI) to facilitate the integration of the banking and capital markets in the WAMZ, the same cannot be said for the insurance sector. The case for insurance integration is further strengthened by the fact that insurance markets in the WAMZ are largely localized within national boundaries, thus limiting cross border insurance, a phenomenon which is popular within the WAMZ banking sector, and gradually gathering steam in the capital markets.

9.0 CONCLUSION

Financial market integration in the WAMZ is not only considered as an important policy tool for ensuring effectiveness of single monetary policy and boosting resilience to asymmetric shocks through a risk sharing mechanism but also for promoting financial inclusion, reducing the cost of funds and enhancing competition in financial markets through the provision of a variety of financial products. The financial sector is undoubtedly at the heart of the WAMZ market economy, playing a major role in intermediating savings and investments. However, WAMZ member countries are at different stages in their level of financial development, hence, it is crucial to ensure that the financial sector is adequately prepared to guarantee financial inclusiveness that would facilitate a seamless introduction of a single currency. The integration of the financial sector has therefore emerged as critical element of the WAMZ regional integration agenda. It is believed that the depth and quality of an integrated financial market can enhance a broad range of choices for savings, investments, thereby facilitating economic growth within the Zone. WAMZ Authorities and Institutions have been implementing various measures to promote the integration of financial markets particularly in the banking and insurance sectors. In 2010, Central Banks in the WAMZ established the College of Supervisors of the West African Monetary Zone (CSWAMZ) in 2010 to enhance supervisory co-operation, harmonize supervisory processes, build capacity of bank examiners, deepen information sharing and strengthen financial stability. The decision to establish the College was consistent with international efforts at improving global financial stability

and harmonization of financial regulations. Furthermore, the need to foster capital market integration also came to the fore on account of larger cross-border flows as well as the need to promote access to larger markets. Consequently, the West African Capital Market Integration Council (WACMIC), comprising the Heads of the Stock Exchanges and Securities and Exchange Commissions, in the UEMOA Zone, Ghana, Nigeria and Sierra Leone was established in 2013, to spearhead the integration of capital markets in the region.

Both the CSWAMZ and WACMIC are major platforms for fostering banking and capital markets integration, respectively. Under the CSWAMZ, the approach to and conduct of banking supervision was being harmonized in line with the minimum international standards. The capacity of bank examiners was being strengthened through period training contemporary tools for banking supervision while financial stability was being enhanced through joint examination of subsidiaries of banking groups. Despite these milestone, the cost of borrowing remains high as little convergence of interest rates had been achieved due mainly to macroeconomic difficulties, low financial and the need further deepen financial policy harmonisation. Under the WACMIC programme, trading and listing rules have been harmonized while the process for cross-border trade in securities have been adopted. However, the existence of capital account restrictions in Member States, possibility of double taxation of dividends as well as the lack of a regional payments system infrastructure present a major challenge to the settlement of cross-border transactions. The challenges to

banking and capital integration in the WAMZ would need to be addressed by further harmonization of banking and capital market regulation, aimed at facilitating banking and capital market operations. Crucially, capital account restrictions among WAMZ Member States should be removed. To promote the insurance sector integration, the roadmap of activities should include harmonization of regulations and supervisory processes and the establishment of a West African Insurance Sector Integration Council of Regulators to oversee the integration of the insurance sector in the WAMZ. In the end, any strategy for financial sector integration in the WAMZ should take into consideration the challenges

and obstacles discussed in Section 7 including a mechanism for addressing of the likelihood of financial contagion arising from pass-through effects of external shocks in any member country in the Zone. The harmonization of regulatory and supervisory frameworks for financial institutions in addition to the liberalization of capital account within the sub-region is critical in fostering financial integration. It also essential for collaboration among regulators to be sustained coupled with promotion of deeper capital market integration. The development of regional payments system infrastructure would also be relevant.

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