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Banking regulatory environment and supervision in Africa

A bank in its simplest form has been described as a financial institution that uses money deposited by customers for investment, pays it out when required, makes loans at interest and exchanges currency. Banks are often regarded as the life-giving force of an economy, the heart of free-market economies. They are important in providing external and internal funding sources to a country by issuing loans to individuals and companies and acting as a "safe-box" for depositors. Banks have the potential of helping to fuel economic growth, raising people's standard of living, self-realisation and inclusion in the process. Equally, as we have witnessed over the past two years, banks can wipe out trillions of dollars of wealth around the world, bringing capital markets and economies to a brink of a collapse (Leo Tilman).[1] The global financial crisis resulted in worldwide banking regulation reforms in different scales, with more stringent regulations on bank capital, liquidity and corporate governance structure being seen as the best way to restore the stability of financial markets.

While banks serve relatively the same purpose globally, there is a plethora of banking regulations across the nations and jurisdictions. In the context of the banking regulatory environment in Africa, this paper aims to draw a comparison of banking regulations, requirements and by-laws of some of the fastest-growing Africa economies in the world, and some of the largest economies in Africa; namely Ghana, Mozambique, Angola, South Africa, Ethiopia, Kenya and Nigeria, highlighting the key commonalities arising among these, along with the areas of differentiation to note when developing entry or expansion strategies in these economies.

The World Bank analysed the banking regulations, and this paper will focus on some of those key pillars identified: Entry into Banking, Ownership, Capital, Activities, External Auditing Requirements, Internal Management/Organisational Requirements; Liquidity and Diversification Requirements, Depositor (Savings) Protection Schemes, Provisioning Requirements, Discipline/Problem Institutions/Exit, and Supervision.[2]

Entry into banking

African economies largely promote and seek inward investment. In the banking sector, this is achieved by allowing foreign firms to establish banks within Africa, following the same requirements and regulations that local banks adhere to. Many of the largest banks in these economies are international banks with branches throughout Africa; for example, the Barclays group holds a majority stake (55.5%) in the South African ABSA group and derives nearly 20% of its revenue from ABSA's African operations. With a reportedly growing middle class in Africa (34% of the continent's population) and a need for sophisticated retail banking services by this newly found affluent class, domestic, regional and international banking groups are pioneering new and innovative retail banking products. This has prompted some governments to take steps towards reduction of barriers to entry into the retail banking sector. According to recent estimates, retail banking in Sub-Saharan Africa is projected to grow by 15% per annum by 2020, bringing the sector's contribution to GDP to 19%, from 11% in 2009.[3]

1 Leo M. Tilman is president of L.M. Tilman & Co., a global strategic advisory firm, and teaches finance at Columbia University

2 The World Bank Database, Banking Survey (2007)

3 Meeting the growing demand for retail banking services in Africa, Mthuli Ncube, African Development Bank

Entry into the banking sector is regulated by each country's central bank, which is the sole authority responsible for issuing banking licences. Barring Angola, Nigeria and South Africa, the minimum capital requirements do not vary depending on the nature of the banking business to be licensed. The minimum capital requirements can be sourced from borrowed funds by the shareholders, except in the instances of the above mentioned three countries. Nigeria and Mozambique do not allow the use of other assets, e.g. government bonds, to be put forward as capital in place of cash, while the other countries provide for the use of other assets. Foreign entities are allowed to enter the banking sector through acquisition, setting up of a subsidiary, branch or joint venture in all countries with the exception of Ethiopia, which strictly does not allow foreign entry in any form of banking. Ghana prohibits the formation of a branch or joint venture by a foreign entity. The period for the issue of a licence from receipt of application to final disposition is less than 12 months on average in all concerned countries excluding Nigeria, where the typical duration is 12 to 18 months.

Ownership

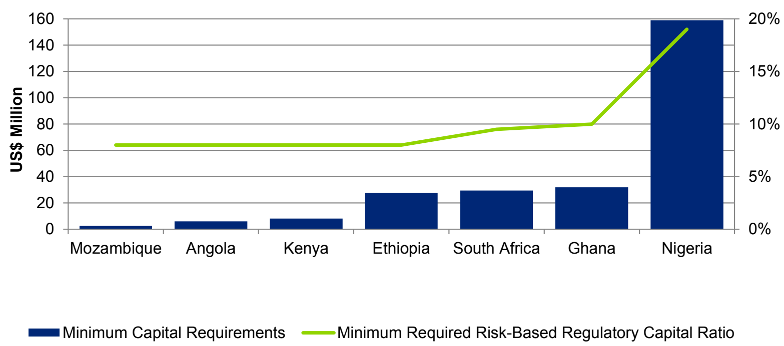
Bank ownership level thresholds exist in certain countries that trigger evaluation and approval requirements by the regulator, such as as the requirement to obtain regulatory approval once the share of bank ownership by an individual, family or group reaches a certain percentage. In Ethiopia, the maximum single shareholding limit by an investor is 5%, including a related party; in Ghana, the limit is 10% of total equity or where the prospective investor will assume a policy role such as a seat on the board. In South Africa, prior permission of the Registrar (< 49%) or Minister (>49%) is necessary for the acquisition of prescribed percentages of the nominal value or voting rights in a bank or controlling company.

In addition, certain countries have policies regarding the ownership of banks by non-financial firms and non-bank financial firms, e.g. insurance companies or finance companies. Ghana allows 100% ownership of the shareholding without prior approval, while South Africa and Nigeria require prior approval from the reserve bank registrar/supervisor for such a stake. The remaining countries place a limit on the number of shares that can be owned by non-financial firms and non-bank financial firms.

Capital

Over the last 20 years, regulatory capital requirements have been refined and broadened to cover various types of risk, differentiate among asset classes of different risk, and allow for a menu of approaches to determine the risk weights to be applied to each asset category. In the process, the rules have become increasingly elaborate, reflecting the growing complexity of modern banks.[4] The importance of adequate capital reserves was stressed during the economic downturn. In 2006, the Governor of the Central Bank of Nigeria (CBN) imposed a higher capital requirement (from 2 billion Naira to 25 billion Naira) on the banking organisations through a reform agenda aimed at improving the stability of banks in Nigeria, which led to the consolidation of the banking industry, reducing the number of banks from 90 to 25. Despite this increase in minimum capital requirements, CBNs extensive auditing of the commercial banks in 2009, revealed that many of the banks were under-capitalised. CBN spent nearly US$3 billion dollars over 2008 and 2009 to bail out and to recapitalise a number of these banks.

As of 2010, all countries used Basel I regimes for regulatory capital adequacy, and adhere to the guidelines of Basel I, except for Ghana, which has a modified Basel I version (currently introducing Basel II), Angola using Basel I equivalent regime, and South Africa applying Basel II. Basel III is to be phased in next year, but due to its various stringent requirements (meant to prevent another banking crisis by increasing capitalisation and improving credit policies); only South African banks look set to implement the regulations fully. Further consolidation in certain markets is expected as capital requirements increase.



4 Bank Capital: Lessons from the Financial Crisis, Asli Demirguc-Kunt, Enrica Detragiache, and Ouarda Merrouche, November 2010

Activities

Another bank regulation issue is activity restrictions. Kremmling (2011) explained that there are four fundamental areas of activity restrictions, namely: securities dealings, insurance business, real estate and non-financial firms dealing. These main areas were also stressed by Barth et al. (2004) in their study on bank regulation. Theoretically, when banking firms deal with nonbanking activities, it will aid the regulatory framework of the bank by providing more transparency; and, as such, banks will not be able to take high risk, compared to banks with activity restrictions. However, most studies have found that banking firms with fewer activity restrictions are not transparent in their dealings and sometimes do not aid bank performance (Kremmling, 2011).

- Insurance and securities activities: Mozambique banks are allowed to directly conduct a full range of both activities in the bank. The remaining countries, excluding Ghana and Ethiopia, impose restrictions in that a full range of insurance securities activities are offered, but they must be carried out in a subsidiary or another part of a common holding company or parent. Since the scrapping of the Universal banking model in Nigeria, the only outlet for banks in Nigeria is to have a holding company arrangement where the holding company owns the bank and other subsidiaries like insurance or securities. Ghana does not allow a full range of insurance activities to be carried out in banks or subsidiaries, or in another part of a common holding company or parent. Ethiopia does not allow any securities activities to be carried out at any bank or subsidiary or another part of a common holding company or parent.

- Real estate activities: A full range of real estate activities is allowed in South African and Angolan banks but can only be carried out in a subsidiary or another common part of the holding company. Ghana, Kenya and Nigeria only allow a lesser range of real estate activities to be carried out within subsidiaries and related parts of the holding company or parent. However, Nigeria does not allow any real estate activities apart from granting mortgage loans to customers with the phase out of the banks owning subsidiaries. Mozambique does not allow for any real estate activities to be carried out in their banks. Although Ethiopia has no law that prohibits banks from financing real estate, there are some temporary restrictions of financing the real estate sector.

- Non-financial activities: Mozambique is the only country among those we are commenting on that allows for non-financial activities to be carried out directly in a bank. Ethiopia does not allow for any non-financial activities to be carried out (whether directly or within the group of associated companies), while the other nations allow for non-financial activities to be carried out only within subsidiaries and/or in another part of the common holding company or parent, subject to regulatory limit or approval.

External Auditing requirements

The Basel committee has noted that the key means of ensuring reliable information within banks is sound and comprehensive internal control and risk management systems, complemented by effective internal audit activities. In addition, assurance about the reliability of disclosed information can be enhanced through audit by independent external auditors. Therefore, supervisors should, in addition to measures to promote strong internal controls and risk management practices within banks, encourage ongoing improvement in auditing standards, ethics and practices. The financial crisis revealed that many banks lacked transparency and reported profits that were based on under-secured and rather reckless lending. In reaction to the economic downturn results, countries that had poor auditing requirements set out to correct this.

- **Appointment of auditors:** All the nations under consideration require all commercial banks to appoint a professional external auditor. Such an auditor is required to have passed a specific exam or to possess an accepted professional qualification and/or to have registered with a recognised professional body. Ghana and Kenya do not impose a requirement of previous banking auditing experience, while the other nations do. Mandatory rotation requirements on the lead auditor exist in every country except Ghana e.g. South Africa and Mozambique have a five-year rotation policy. A rotation policy for the audit firm exists in all countries, except Kenya and South Africa. A further step is taken by Angola, Ghana, and South Africa in that the banks are required to nominate more than one external auditor (joint auditors).

- **Audit Scope:** Regulations in these countries require audits to be conducted in accordance with the International Standards on Auditing (ISA). Regulations in Ghana and Mozambique do not restrict audit firms from providing non-audit services to the banks that they audit, while the remaining countries restrict such practices or require disclosure and consideration of non-audit fees. In Mozambique, central bank can disapprove the auditor based only on circumstance that can impair the independancy, cause buyers, or inability of auditor.

- **Audit Findings and reports:** All countries require the audit report on the financial statements to be made publicly available and handed to the central bank or banking regulatory body. The audit statements are to be accompanied by the auditor's letter to the bank management. South Africa and Angola require all other communication between the auditor and the audit committee to be submitted to the registrar of banks or banking supervisor. Ghana excluded, auditors in other countries are required to communicate any involvement by senior management and/or directors of the bank in illicit activities, fraud or insider abuse to the registrar/supervisor. With the exception of Angola and Ethiopia, all the countries have their 10 biggest banks audited by at least one of the international audit firms.

Bank governance

Bank governance is deemed necessary for the survival and the success of a bank. A prime example of good bank governance is South Africa. South Africa's banks rank second in the world for soundness, according to the Global Competitiveness Report 2012/13. The Banks Act of 1999, which sets out strict rules in terms of audit committees, directors' suitability and qualification, mandatory disclosure to the public and the power of intervention by the Reserve Bank of South Africa has led to South African banks surviving and thriving through the economic downturn without the need for bailouts and recapitalisation. The establishment of an audit committee is mandatory in all reviewed countries, except Angola and Ghana.

Disclosure of remuneration packages of senior management is only mandatory in South Africa. There is also mandatory disclosure of directors emoluments in Nigeria per Part V section 22 Third schedule of the Companies and Allied Matters Act and Securities and Excahnge Commission code of corporate governance section 14.10. A responsibility is placed on the board of directors for accurate and truthful financial and regulatory reporting, including mandatory public disclosure, throughout all reviewed countries, excluding Ghana and Angola. Regulations for the separation of the role of the CEO and chairman of the Board, application of provisions covering related party transactions and the appointment of a fit and proper Board and of senior management are all mandatory throughout all the countries. The remuneration of the board, senior management and other bank staff (e.g. traders) is evaluated by the supervisor to ensure that it does not lead to excessive risk-taking. This applies across all the countries, except Nigeria.

Liquidity and diversification requirements

African banks are generally in good liquidity positions, due to the stringent requirements set by their governing authorities. Reuters Africa recently reported that Kenya's shilling managed to hold firm against the US dollar due to the tight stance taken by its central bank on liquidity.

- **Risk concentrations:** Commercial banks in all countries are limited to lending from one borrower and/or a group of inter-related borrowers. A limit is further placed on the amount that can be lent in relation to the capital held. In all countries that allow a limit of 20% of regulatory capital, 25% of the regulatory capital held is the debt limit for any bank. Nigeria placed lending limit of 20% of regulatory capital to one borrower and/or a group of inter-related borrowers. In addition, Nigeria also placed lending limit of 10% of total credit portfolio to all tiers of government and their agencies. In the application of the lending limit regulation, there are some exempt items, e.g. cash-secured lending or government-guaranteed lending. All banks, except those in Ethiopia and Ghana are allowed to make loans abroad.

- **Regulatory liquidity requirements:** In assuring adequacy of liquidity, all countries, except Nigeria, require diversification of funding sources, contingency funding plans that include stress testing (this also applies to foreign branches), banks' liquidity management of foreign currency, and a reserve to be in place at the central bank for deposits. Ghana and Kenya are the only countries of the group to impose maturity mismatch limits.

Depositor (savings) protection schemes

Few African countries offer Depositor protection schemes. In Nigeria, for example, limited insurance cover is carried out by the Nigeria Deposit Insurance Corporation (NDIC). This is required by the Act setting up NDIC and is done specifically by all the banks, who are responsible for the payment of the insurance premium after necessary determination by the NDIC. The Reserve Bank of South Africa has argued that the implementation of explicit deposit insurance schemes would be excessively costly, both directly and in terms of opportunity costs. The governing body argued that it would be far too costly to cover the failure of just one of South Africa's largest banks, and that in reality without 100% depositor coverage, depositor insurance schemes are largely ineffective. This was the case with British bank Northern Rock, which despite having depositor insurance went into a bank run (depositors pulling out savings at the same time) due to the loss of confidence in the bank, as they received liquidity support from the Bank of England in 2007. In light of this, very few African countries offer deposit insurance scheme. Kenya has a deposit protection fund to which banks contribute based on their deposits but this covers depositors only up to US$ 1170.00.

Asset classification, provisioning and write-off requirements

All of the countries in our study have an asset classification system under which banks have to report the quality of their loans and advances, using a common regulatory framework. Minimum levels of specific provisions for loans and advances are set by the regulators and are linked to the asset classification system. With the exception of Angola, Nigeria and South Africa, the provisioning rules allow for the value of the collateral to be deducted from the amount of a loan or advance before provisioning is applied. The minimum provisioning required for a standard loan in Angola is 1%, which rises to a level of 100% for both a doubtful or loss loan. By comparison, the standard loan-provisioning minimum in Ghana, Ethiopia, and Kenya ranges between 20% and 100% for a loss loan. Non-performing loans may be written off after 6 and 12 months in Angola and Nigeria and there is no write off requirement in the Central Bank of Kenya prudential guidelines respectively. The asset classification and provisioning rules apply to commercial banks, all types of borrowers, loans and advances to borrowers. Asset classification and provisioning in Nigeria effective from FY2012 will be driven by the provision of IAS 39, which is incurred loss basis rather than % basis since the recent adoption of IFRS.

Discipline/exit

- **Enforcement:** In regulating the banking sector, the supervisor has certain powers to enforce discipline and adherence to rules. For example, cease and desist-type orders for imprudent bank practices; requirements for a bank to meet supervisory requirements (e.g. capital and liquidity) that are stricter than the legal or regulatory minimum; withdrawal of a bank's licence; suspension or removal of bank directors; and commitments/actions from controlling shareholder(s) to support the bank with new equity (e.g. capital restoration plan). In Angola, Ethiopia, Ghana and Kenya, the supervisor is required to make public all enforcement actions imposed on any bank.

- **Resolution:** In terms of which authority has the right to the use of resolution powers in the case of declaring a bank insolvent, the bank supervisor holds this power in Ethiopia, Kenya, Mozambique and Nigeria, while such power is held by the court in the case of South Africa and Ghana. Angola allots such power to its central bank. The same allocation of power by each country above applies in superseding shareholders' rights. In removing and replacing bank senior management and directors, this power is dispensed to the bank supervisor across all nations, while Angola allots such power to the central bank.

Supervision

In early October 2012, the Fitch rating agency mentioned the improved supervision by central banks in Africa as part of the reason for the slow but growing Sub-Saharan African economy as a whole. The greater supervision placed on banks, high levels of liquidity, and relatively low levels of loan default, have led to increased confidence in the African finance sector, and rejuvenated the issuing of credit needed to stimulate further growth.

- **Institutional structure and mandate:** Across all the reviewed countries, with the exception of Nigeria (which has multiple supervisory agencies, including the central bank), the agency that supervises commercial banks for prudential purposes is the central bank of the country. South Africa is the only country in which some banks do not fall under the supervision of the central bank, because certain institutions such as the Land Bank are not governed by the Banks Act 1990 and have separate supervisors in the National Treasury.

The central banks of all the above countries have a specific written mandate in terms of supervision, and the following examples of financial system responsibilities are included in the mandate: financial stability, financial market access/development, consumer protection, prevention of financial crime (anti-money laundering or combatting financing of terrorism). In essence, all central banks are accountable to parliament, or in some cases a specific cabinet minister, or directly to the president in the case of Angola. The supervisory agency is appointed by the decision of the head of government in all countries but South Africa, where the Finance Minister appoints such an agency.

- **Supervisory approach:** In terms of banking supervision, all the countries place the highest importance on assessment of the risk profile, strategic direction, financial condition, internal governance and controls and risk management. The internal organisation of banking supervision can best be characterised as Integrated onsite and offsite activities for each entity under a senior/managing supervisor. The bank rating system throughout the nations is best described as a broad risk-rating system, combining quantitative and qualitative measures of inherent risk, management and controls and residual risk by type of bank activity and/or risk category. As such, the intensity and frequency of supervisory activities are explicitly linked to the bank's risk rating.

Closing thoughts

While there are differing bank regulations in the selected markets, there has been a definitive move by bank regulators to strengthen banks across the continent. This creates a platform for the high economic growth in Africa and shows the commitment of policymakers to create appropriate platforms for growth.

Summary of banking regulations

	Angola	Ethiopia	Ghana	Kenya	Mozambique	Nigeria	South Africa
Entry into banking							
Banking licence issuing agency	Banco Nacional de Angola	National Bank of Ethiopia	Bank of Ghana	Central Bank of Kenya	Central Bank of Mozambique	Central Bank of Nigeria	Registrar of Banks[5]
Minimum capital entry requirement vary depending on the nature of the banking businesses that are licensed	Yes[6]	No	No	No	Yes	Yes[7]	Yes[8]
Minimum Capital Requirements[10]	US$6 million	US$27.7 million	US$31.9 million	Currently US$8 196 720 to be increased to US$11 709 600 by end of 2012	US$2.5 million	US$159 million	US$29.4 million or 10% of risk weighted assets, higher of the two
Applications for commercial banking licences from domestic entities in the past five years (2006–2010)							
Received	10	7	2	4	2	--- [9]	1
Denied	0	0	0	0	0	---	1
Withdrawn	0	0	0	0	0	---	0
Accepted	10	7	2	2	2	---	0
Foreign entities allowed entering	Yes	No	Yes, except branch or joint venture	Yes	Yes	Yes	Yes
Maximum % of foreign ownership	100%	0%	100%	100%	100%	100%	100%

5 Supported by Bank Supervision Department of the South African Reserve Bank

6 Os requerimentos mínimos de capital social e fundos próprios, podem ser reduzidos em 50% (cinquenta porcento), no caso da sede da instituição se situar fora da capital social do País. (Vide ponto 1 do artigo 3.º do Aviso N.º 04/07 de 12 de Setembro)

7 With the introduction of the new banking model in 2010, banks are categorised into (a) Commercial banks with (i) International, (ii) National, (iii) Regional authorisation (b) merchant banks and ©Specialised banks with different capital requirements.

8 The minimum capital requirement is the greater of ZAR250 million or a prescribed percentage of the sum of amounts relating to the different categories of assets and other risk exposures and calculated in a prescribed manner.

9 --- means not applicable or data not available

10 Please note that the US$ value may vary due to the exchange rate fluctuations

Summary of banking regulations - continued

	Angola	Ethiopia	Ghana	Kenya	Mozambique	Nigeria	South Africa
Applications from foreign banks in the past five years (2006–2010)							
Received	1	0	1	1	4	---	1
Denied	0	---	0	0	0	---	0
Withdrawn	0	---	0	0	0	---	0
Accepted	1	0	1	1	4	---	1
Ownership							
Maximum % of a bank's equity by single owner	No	Yes, 5%	No	Yes, 25%	Yes	Yes	No
Capital							
Basel I regimes used for regulatory capital adequacy	Yes Basel I equivalent regime	Yes	Yes	Yes	Yes	Yes	Basel II
Minimum required risk-based regulatory capital ratio as at 2010	10%	8%	10%	8%	8%	19%	9.5%
Basel II framework, target calendar year of adoption	---	---	2012	---	2014	---	2008

Summary of banking regulations - continued

	Angola	Ethiopia	Ghana	Kenya	Mozambique	Nigeria	South Africa
Legally allowed in regulatory capital							
b.Tier 1 Capital[11]	Yes	Yes	Yes	Yes	No	Yes	Yes
Minimum	10%	---	0%	8%	---	100%	7%
Maximum	---	---	100%	8%	---	---	---
c.Tier 2 Capital [12]	---	No	Yes	No	No	Yes Subject to 100% of Tier 1	Yes[13]
Maximum	---	---	100%	---	---	---	100%
Activities							
A bank may own a % of equity in any non-financial firm	100%	20%	100%	100%	50%	---	100% [14]

11 Tier 1 capital includes common stock and retained earnings and is the basis on which a bank supports its deposit and lending operations. Also referred to as core capital or primary capital.

12 Tier 2 capital is the second part of the two-tier risk based standard commonly used by regulatory agencies (such as a central bank) to assess a financial institution's capital adequacy. Also called supplemental capital, it includes subordinated debt, convertible securities, and a percentage of loan-loss reserves.

13 The following is applicable for Tier 2 and Tier 3 capital in South Africa:

(Non-redeemable, non-cumulative preference shares and hybrid debt instruments may not exceed 25% of total primary capital and reserve funds;

Secondary capital and reserve funds and tertiary capital may not exceed 100% of primary share capital and reserve funds;

Subordinated term debt may not exceed 50% of primary share capital and reserve funds; and

Hybrid debt instruments may not exceed 15% of primary share capital and reserve funds)

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