Review of Ghana's Bank Regulatory and Supervisory Practices in Accordance with Basle Committee's Standards

February 2000

Sigma One Corporation

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by:

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In fulfillment of the following milestones:

3.7 Review of Ghana's Bank Supervision regulations and practices in accordance with "Basle Committee's" standards.

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Trade and Investment Reform Program, Improved Policy Reform and Financial Intermediation

Basle "Core Principle"	Comment on Regulatory-Supervisory Practice	Recommendation
Principle 1: An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banking organisations. Each such agency should possess operational independence and adequate resources.	The BoG law does not provide adequate autonomy for the central bank to supervise the banking system. The central bank must consult and/or secure the approval of government in the licensing of banks, adjusting the minimum capital adequacy requirements, initiating action against and taking over distressed banks.	The BoG law should be revised to enable the central bank to grant and terminate a bank license, change capital adequacy requirements and take serious actions against distressed banks without recourse to and prior approval of government. The BoG should have broad powers to issue and enforce prudential regulations.
Principle 2: The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word "bank" in names should be controlled as far as possible.	There is not complete listing of permissible activities in which banks can engage in the law. Some financial institutions, such as credit unions and susu collectors, are not licensed.	The Banking Law should be revised to include a detailed list of permissible activities that licensed banks can engage in. Regulatory oversight of mutual institutions that conduct financial intermediation should be regularised.
Principle 3: The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organisation's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organisation is a foreign bank, the prior consent of its home country supervisor should be obtained.	The criteria for licensing banks is set out; but that for some other financial institutions is not transparent. Concern has been raised regarding the vetting of directors through the security check processes of the Ministry of Interior, in which candidates are subjected to irrelevant and inappropriate questions with respect to "fit and proper" criteria for proposed directors.	The BoG should establish clear and transparent criteria for licensing of banks and other financial institutions. The central bank should establish the questions and forms to be used in conducting security checks for proposed directors of banks and other financial institutions, in line with "best international practice", that are appropriate for establishing, in an efficient and timely manner, whether candidates are "fit and proper".
Principle 4: Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.	As at October 1998, the central bank did not have established procedures in place for reporting of major changes in ownership or acquisitions.	The BoG should establish formal procedures through which major changes in ownership of acquisitions by banks is reported to the central bank.

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Principle 5: Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.	There are criteria limiting investments by banks in non-bank financial institutions. Investment in any one non-bank financial institution subsidiary cannot exceed 15% of capital, and for all non-bank financial institution subsidiaries cannot exceed 25% of capital.	
Principle 6: Banking supervisors must set prudent and appropriate minimum capital adequacy requirements for all banks. Such requirements should reflect the risks that the banks undertake, and must define the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, these requirements must not be less than those established in the Basle Capital Accord and its amendments.	The risk-adjusted capital adequacy ratios for the banks employed by the BoG is different from that recommended by the Basle Standard, and in general slightly more stringent. For non-prudential reasons, export credits are assigned lower risk weights, even though higher risks would be expected, and even when such credits become non-performing. Other risk weights are much higher than that recommended under the Basle formula.	The capital requirements for establishing new banks should be increased to account for erosion in real value due to inflation. The process of review and adjustment of the minimum capital requirement for a new should be regularised through banking regulations. Other capital adequacy ratios should be consistent with, albeit somewhat higher than, those of the Basle formula so as to facilitate assessment of bank solvency compared to international standards.
Principle 7: An essential part of any supervisory system is the evaluation of a bank's policies, practices and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios. Supervisors need to ensure that the credit and investment function at individual banks is objective and grounded in sound principles. The maintenance of prudent written lending policies, loan approval and administration procedures, and appropriate loan documentation are essential to a bank's management of the lending function.	The lack of credit histories and credit rating agencies constrain establishing safe lending practices. The difficulty in securing contract enforcement in the courts, as well as the absence of a commercial court, results in distorted lending practices: lending is biassed towards short term credits backed by very liquid collateral. The lack of a yield curve with much duration for government securities also constrains pricing of credit instruments to the private sector.	Efforts should be pursued to establish one or more credit rating and reference agencies, with a shared database on credit histories. Judicial reform and the establishment of commercial courts needs to be pushed. Government should issue domestic debt of longer maturities to create a term structure to facilitate pricing of interest rate and credit risk to corporate clients.
Principle 8: Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices and procedures for evaluating the quality of assets and the adequacy of loan loss provisions and loan loss reserves.	There are five categories of loan provisioning: current (1%); potentially sub-standard (5%-15%); sub-standard (25%); doubtful (50%) and loss (100%). BoG examiners can require additional provisioning if felt appropriate. Thus, this principle is followed by the central bank.	

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Principle 9: Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.	The banking regulations limit single borrower exposure to 25% of bank capital for secured credit and to 10% for unsecured credit. While exposure to the largest 50 loans is reported to the central bank, there is no exposure limit on total credit to large borrowers.	The BoG should establish a clear definition of large borrower, and set a global restriction on credit to all large borrowers.
Principle 10: In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.	The banking regulations do limit lending to firm's in which the bank's directors have interests, as well as to directors and the bank's staff.	
Principle 11: Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.	As at October 1998, this principle was not being adhered to. There was no capital required for exposure to market risks, including foreign exchange risk. Nor was there any capital required for interest rate risk.	The BoG should introduce guidelines for measuring market risk, and set capital requirements for such risk in line with Basle guidelines.
Principle 12: Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor and adequately control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.	Maturity gap analysis is monitored, but there are no guidelines for supervisors to apply. In general, Ghanaian banks do not have adequate risk management systems in place.	The BoG should introduce guidelines for measuring and managing interest rate risk, and set limits on duration gap.

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Principle 13: Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor and control all other material risks and, where appropriate, to hold capital against these risks.	In general, Ghanaian banks do not have internal control systems and risk management units in place that can adequate measure market or interest rate risk, and thus control for them.	The BoG should foster the establishment of risk management units and internal control systems in each bank, which can help detect future problems and sources of financial losses. The risk management unit should report directly to the board of directors of the bank.
Principle 14: Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls, as well as applicable laws and regulations.	While some of the foreign banks do have adequate systems in place to measure and manage market and interest rate risks, in general the banks lack internal control procedures and capacity for risk management.	See above recommendation.
Principle 15: Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.	Ghana has no provisions on money laundering.	The BoG should adopt the FATF principles and strategies to combat money laundering.
Principle 16: An effective banking supervisory system should consist of some form of both on-site and off-site supervision.	The BoG engages in both on-site and off-site supervision for both banking and non-bank financial institutions, but resources (especially computer hardware and software) for effective supervision are considered inadequate.	The BoG needs to consider ways to put the effective supervision of banking and non-bank financial institutions on a sound and sustainable basis. This should include cost-sharing amongst banks.

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Principle 17: Banking supervisors must have regular contact with bank management and a thorough understanding of the institution's operations.	The BoG does not have frequent enough contacts between the senior supervising officers and the banks being supervised. Supervisory staff are not attached to banking institutions to learn about and appreciate industry- and bank-specific procedures and practices.	The central bank needs to establish better consultative mechanisms with the banks, at both technical and senior management level, to review banking system issues, identify needed regulatory changes and reforms and build a spirit of consensus and cooperation for sound financial sector development.
Principle 18: Banking supervisors must have a means of collecting, reviewing and analysing prudential reports and statistical returns from banks on a solo and consolidated basis.	Financial institutions submit reports on liquid asset requirements, assets and liabilities, large exposures - loan limits, analysis of loans, capital adequacy, maturity of assets and liabilities, profits and losses, loan classification, capital expenditure, statutory report, and changes in operations and branch-agency locations.	
Principle 19: Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.	In addition to internal audit arrangements, banks are audited by major international accounting firms, the programmes of which must be submitted beforehand to the central bank.	
Principle 20: An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.	This principle is not being complied with; the banks do not report on a consolidated basis. Foreign banks are supervised by both home and host supervisors.	The BoG should implement regulations to ensure that all banks submit consolidated reports where appropriate.
Principle 21: Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.	Commercial banks observe internationally accepted accounting principles.	

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Principle 22: Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking licence or recommend its revocation.	The central bank does not have adequate powers to enforce compliance with laws or take timely corrective actions. The requirement to seek MoF approval to act against banks in breach of regulations or to take over troubled institutions can obstruct effective banking system supervision and distort central bank decision making.	The BoG Law and the Banking Law should be revised to provide greater autonomy and powers to the central bank to supervise the financial system and take timely action with respect to troubled banks to suspend their activities, implement exit policies, transfer assets and liabilities, remove managers who are not "fit and proper" and impose penalties adequate to enforce compliance. The Laws should also be revised to ensure greater transparency and accountability by the central bank for financial system performance.
Principle 23: Banking supervisors must practise global consolidated supervision over their internationally active banking organisations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organisations worldwide, primarily at their foreign branches, joint ventures and subsidiaries.	This principle is not being complied with; the banks do not report on a consolidated basis. Foreign banks are supervised by both home and host supervisors.	The BoG should collaborate with home country supervisors of foreign banks to ensure their consolidated performance meets internationally accepted standards, while their local operations meet appropriate prudential norms for all domestic aspects of the business.
Principle 24: A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.	As noted above, the banks do not report on a consolidated basis and foreign banks are supervised by both home and host supervisors, with limited exchange of information between the different supervisory authorities.	The BoG should collaborate fully with the various other supervisors involved with the foreign banks in particular, and with all banks engaged in international transactions.
Principle 25: Banking supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.	While foreign banks are required to perform to standards at least as high as those of domestic banks, the banks do not report on a consolidated basis. Foreign banks are supervised by both home and host supervisors.	The BoG needs to strengthen its relationships with other supervisory authorities.