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Financial Sector Strategic Plan

May 2000

Sigma One Corporation

Sigma One Corporation (U.S. Office)
Post Office Box 12836
Research Triangle Park, North Carolina 27709-2836

Phone: (919) 361-9800
Fax: (919) 361-5858
E-mail: Sigma1@SigmaOne.Com

Financial Sector Strategic Plan

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Compiled by:

Sam Mensah
Sigma One Corporation

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Table of Abbreviations

ATM	Automatic Teller Machine
BOG	Bank of Ghana
CRA	Credit Reference Agency
CUA	Credit Union Association
ECOWAS	Economic Community of West African States
FINSAC	Financial Sector Adjustment Credit
FINSAP	Financial Sector Adjustment Program
FSCC	Financial Sector Consultative Committee
IDA	International Development Association
IMCC	Inter-Ministerial Committee on Competitiveness
IPO	Initial Public Offer
LDM	Licensed Dealing Member
MFI	Microfinance Institution
NBFI	Non-Bank Financial Institution
NCFR	National Committee of Financial Regulators
NTHC	National Trust Holding Company
SIL	Securities Industry Law
SRC	Securities Regulatory Commission
SSNIT	Social Security and National Insurance Trust
TIN	Taxpayer Identification Number
TIRP	Trade and Investment Reform Program

EXECUTIVE SUMMARY

This strategic plan has been prepared by the Financial Sector Consultative Committee (FSCC), a committee established by the Bank of Ghana as part of the Trade and Investment Reform Program (TIRP). TIRP has, as a primary objective, the promotion of participatory policy change that addresses key issues regarding macroeconomic, trade and investment policies, and the streamlining of the regulatory process to facilitate rapid growth in the economy.

The Inter-Ministerial Committee on Competitiveness (IMCC), which is chaired by the Minister of Finance, oversees TIRP. Other members of IMCC are the Bank of Ghana, Ministry of Trade and Industry, Ministry of Food and Agriculture, National Development Planning Commission and the Private Enterprise Foundation.

This strategic plan is for consideration and adoption by the IMCC. The FSCC has prepared the strategic plan after extensive consultation with regulatory agencies, financial institutions and other stakeholders of the financial system. A *National Action Plan* has been prepared as part of the strategic plan to guide relevant agencies on the steps that need to be taken to implement the recommendations embodied in the strategic plan.

Vision 2020 calls for a major improvement in the levels of investment and savings in order to move Ghana to middle income status by the year 2020. As envisaged at the initiation of the plan in 1995:

- Private investment was to rise from 11% of GDP to 16.5% of GDP, while total investment is to rise from 20% of GDP to 26% of GDP

- Domestic savings was to rise from 2.7% of GDP in 1993 to 20% of GDP by 2000

However, both savings mobilization and investment have stalled. This strategic plan proposes strategies for removing the bottlenecks in the financial sector and for a sustained sector development consistent with Vision 2020. Such a financial system should have three key attributes:

- An efficient medium of exchange for exchanging goods and services

- The creation of capital on a scale large enough to satisfy the needs of the economy

- The existence of markets for the transfer of financial assets such as stocks, bonds and shares and for the conversion of such assets into cash

Simultaneously, an effective regulatory system is needed to minimize the contagious effects of financial institution failure.

The Current System

The reforms of the 1980's and 90's initiated through the Financial Sector Adjustment Program (FINSAP) and the Non-Bank Financial Institutions Assistance Credit of 1995 have showed some positive results. The system has the basic ingredients of an effective financial system as reflected in the attributes above. Positive developments include the following:

- Privatization of the banking sector has proceeded steadily with only the National Investment bank and the Agricultural Development Bank now in the public domain.

- The licensing of several new banks has increased competition in the banking sector.

- The pace of innovation has increased as reflected in an increasingly computerized banking sector and new products.

- Regulation of financial institutions has improved through a strengthening of the banking and non-bank financial sector supervision at the Bank of Ghana, a revamped National Insurance Commission and the establishment of the Securities Regulatory Commission.

The system, however, still faces several constraints, which are summarized below:

1) Legal, regulatory and supervision weaknesses reflected in the following:

- Lack of consultation between regulatory agencies, regulated institutions and other stakeholders such as individual and corporate users of financial services and the public at large.

- Lack of coordination between regulatory agencies, reflected in costly duplication of activities of regulatory agencies, conflicting objectives and rules.

- Lack of operational independence of financial sector regulatory agencies.

- Outdated legislation such as the Companies Code, the Bankruptcy Law, the Exchange Control Act, the Banking law, the Insurance Law, the Financial Institutions (Non-Banking) Law and the Bills of Exchange Act.

- Low budgets and inadequate capacity of regulatory and policy agencies reflected in delays in getting regulatory approvals.

- Key registries such as the Registrar-General's Department and Land Registries are ineffective. Storage and retrieval mechanisms are poor.

- Delays in debt recoveries.

2) Agency specific constraints

- The National Insurance Commission

  - The Commission lacks representation from insurance brokers; representatives of organizations who have been invited to serve are appointed at the pleasure of the Minister.

  - Offshore insurers are doing business in Ghana because of lack of national retention guidelines.

- The Registrar-General

  - There is no enforcement of the provisions of the Companies Code.

3) Sector Issues

- Insurance

  - The Insurance Law still leaves a monopoly in favour of state companies.

  - The requirement for insurance companies to have prior approval of the Commissioner of Insurance for investments is unduly restrictive.

- Banking

  - The definition of banking is becoming increasingly meaningless with commercial banks, merchant banks and development banks all offering a common set of retail and wholesale products.

- There is an inconsistency between the prohibition of the acceptance of foreign currency for the payment of transactions and the permission for banks to offer foreign currency accounts that may be used to settle transactions.

Opportunities, Threats and Strategic Options

Financial sector development needs to be cast in the context of the competitiveness of Ghana's economy. The following regional and global issues need to be addressed:

1) Ghana's regional competitiveness is threatened by the recent opening of the Regional Stock Exchange in Abidjan. There are now three stock exchanges in the ECOWAS region – Ghana, Nigeria and the Regional Stock Exchange. The Ghana Stock Exchange is the smallest and lags the others technologically.

2) The weak cedi makes Ghana uncompetitive given that it is surrounded by the stable and convertible CFA Franc.

3) Linkage to global capital markets is weak. Ghana has no sovereign rating.

4) The concept of Gateway has not been articulated in financial terms.

5) Globally, financial systems are moving towards convergence with banks increasingly offering investment banking services while other financial institutions such as securities firms are offering savings and payment services. Ghana has not positioned itself to deal with this type of convergence.

Broad Strategies for Financial Sector Development

The overall strategic thrust should be guided by the following:

1) Leadership within the ECOWAS region achieved through financial innovation, support for financial institutions to expand regionally in the ECOWAS region and integration of financial sector development with the Gateway Project by making Ghana an internationally recognized financial centre.

2) Integration with the global financial system by raising the standards of financial practice to accord with international best practice. This would include commitment to achieving international standards as promulgated by the Basle Committee on Banking Supervision, International Association of Securities Organizations, and the International Federation of Stock Exchanges.

3) A cornerstone of national strategy should be the ultimate goal of a sovereign rating and sovereign access to the global capital markets to pave the way for Ghana's private sector to enter international financial markets.

4) The promotion of financial innovation through a facilitating environment and public-private partnerships. Regulatory agencies should create structures for seeking out innovations and adapting their regulations to support such innovations.

Specific Recommendations

Management of Industry Change

- The Ministry of Finance should coordinate the preparation of *Industry Development Framework* papers by the Bank of Ghana, National Insurance Commission and the Securities Regulatory Commission for the banking/non-bank financial, insurance and securities industries, respectively. Each framework paper should capture the likely course of development of the industry over a 5-10 year period and identify the regulatory and institutional changes that would be required.

- Regulatory agencies should use the *Industry Development Framework* as input into its institutional planning.

Legal, Regulatory and Supervisory Recommendations

- The Financial Sector Consultative Committee should be institutionalized to serve as a permanent consultative forum on financial sector issues. To achieve this result, resources should be sought to support the work of the Committee on an ongoing basis.

- The FSCC should be given the mandate to sponsor an Annual Financial Markets Conference to bring together all stakeholders in the financial sector to review progress on the implementation of the Financial Sector Strategic Plan and to bring the most up-to-date knowledge and experience to bear on updating the strategic plan.

- Regulators proposing regulatory changes should hold public forums, which should include both regulated institutions and other stakeholders such as individual and corporate users of financial services, service providers and experts.

- Government needs to respect the independence of regulator. Both the law and practice must be such that regulatory agencies can take action without reference to the government.

- Regulatory agencies should actively promote attachment of their staff to industry and must recruit from industry.

- Financial autonomy of regulatory agencies and registries should be promoted through adequate user charges.

- Vetting of directors nominated by financial institutions should focus on "suitability" rather than "security". A common database of directors of regulatory agencies should be set up.

- A permanent National Committee of Financial Regulators (NCFR), consisting of the Bank of Ghana, the Securities Regulatory Commission and the National Insurance Commission, should be established to promote regulatory coordination and cohesion in financial sector development.

- Registries should be given financial autonomy so that they can use user charges to upgrade their services.

- Specialized commercial courts and adjudicating tribunals should be set up to speed up debt recovery and dispute settlement.

- An accelerated program should be initiated to review and upgrade key pieces of legislation such as the Companies Code, the Bankruptcy Law, the Exchange Control Act, the Banking Law, the Insurance Law, the Financial Institutions (Non-Banking Law) and the Bills of Exchange Act. The Committee recommends that a new Companies Code be put in place by the end of year 2002. Financial limits should be removed from laws and regulatory agencies should be empowered to promulgate limits after appropriate consultation.

Agency-Specific Recommendations

- A comprehensive review of the Insurance Law should be undertaken. This should cover the composition of the board and the manner of its appointment, adequate intervention powers for the NIC, national retention limits for reinsurance and the minimum ownership requirements for Ghanaians.

- Resource capacity of the Bank of Ghana and Ministry of Finance should be strengthened to enable them to keep up proactively with changes in the financial sector.
- The Registrar-General's Department should be granted financial autonomy so that it can charge appropriate user fees to fund improvements in service.

Sector Recommendations

- The monopoly of state-owned insurance companies should be removed; the Commissioner's prior approval of insurance company investments should be reviewed.
- The review of the Banking Law should create an equal playing field for all institutions that offer retail and wholesale banking services.
- The operation of foreign exchange bank accounts should be reconciled with the prohibition on payments in foreign currency for transactions in Ghana.
- The Financial Institutions (Non-Banking) Law should be reviewed with a view to relaxing regulatory requirements for non-depository institutions and possibly dropping some categories of institutions from the schedule of NBFIs.
- A one-time incentive should be provided in the form of a generous tax allowance for flotation costs incurred by companies wishing to list on the Ghana Stock Exchange.
- The 10% dividend withholding tax should be abolished to match the tax-exempt status of interest income.
- Restrictions on foreign portfolio investors should be repealed.
- Government should accelerate the introduction of group and individual supplementary pension plans that have equal tax-deductibility treatment with respect to contributions.
- The legal framework with respect to the operation of a Credit Reference Agency should be established as part of the effort towards the establishment of a Credit Reference Agency.

Financial Intermediation Issues

Recommendations

- The rules governing the conduct of the weekly Treasury Bill auction should be published for the information of the public
- The Bank of Ghana needs to increase its investment in public information and education in order to dispel the widespread perception of interference in the weekly Treasury Bill auction. This should include periodic general forums to educate the public.
- To promote the development of a fund management industry:
  - There should be a partial outsourcing of the management of SSNIT funds.
  - Government should promote private pension funds
  - The Securities Regulatory Commission should accelerate development of collective investment schemes.
  - The National Insurance Commission should liberalize rules for insurance company investments within prudential guidelines.

- The development of a credit information system should be accelerated through the following measures:

◆ The establishment of a credit reference agency, credit bureau and rating agency should be speeded up.

◆ The Bank of Ghana, the Securities Regulatory Commission and the National Insurance Commission should mandate the use of the Social Security Number for all financial sector transactions (banking, brokerage and insurance) as part of prudential requirements.

◆ Business users of financial services should be identified by the Taxpayer Identification Number (TIN)

Sector Recommendations

Banking

- The Bank of Ghana should foster greater competition by requiring banks to publish and display banking charges, interest rates and commissions and to give adequate notice when changes are being made to the schedule of fees.
- The Association of Banks should sponsor broader public education about activities of banks.
- Steps should be taken to improve the effectiveness of cheques as a payment mechanism.
- Efforts of the National Payments Council to bring rural banks, credit unions and savings and loan companies into the payments system should be intensified.
- Government should set an example by ensuring that government cheques are not returned unpaid for whatever reason.
- The banking industry should explore possibilities outside the legal system for sanctioning habitual writers of dud cheques (including higher charges, private sector cheque verification companies, etc.)
- Net foreign exchange risk exposure should be set depending on bank strength.

Securities Industry

- The SRC should build the capacity of public officials to understand and appreciate capital market issues through a public education campaign.
- The Bank of Ghana should provide a 3- 5-year bond, to be issued at least once a year to provide a benchmark interest rate and extend the yield curve.

SSNIT

- Outsource corporate lending to financial institutions by providing wholesale funds.

Insurance

- The National Insurance Commission and the Insurers Association should collectively step up educational programs in print and electronic media to educate the public on the benefits of insurance.
- The National Insurance Commission should work with the insurance industry to set up a training facility.
- Government should use Ghanaian insurers to insure foreign credit lines to the government.

- A national reinsurance policy should be put in place to ensure maximum retention by Ghanaian companies.

MICROFINANCE

- Rural Banks

- Bank of Ghana should develop a stringent rating system to identify strong rural banks.

- Strong rural banks should be integrated into the national banking system through interlinkages.

- There should be stricter enforcement of corrective measures and penalties for non-compliance with sound banking practices.

- Credit Unions/Savings and Loans

- Reserve requirements should be aligned with those of banks, with supplementary requirements if necessary.

- Promote capacity-building programs for the Credit Union Association (CUA) and Savings and Loan companies.

- *Susu* Collectors

- All *susu* collectors should be registered.

- National and regional associations should be strengthened to be self-regulatory organizations.

- The largest *susus* should be linked with formal financial institutions.

Financial Innovation

A balanced approach that promotes innovation within reasonable prudential guidelines should be adopted.

1. The Bank of Ghana, Securities Regulatory Commission and National Insurance Commission should appoint a *New Products Officer* to research emerging new products both in Ghana and internationally and to advise the respective regulatory agency on appropriate regulatory adjustments to accommodate such products. The New Products Officer should provide technical support to the regulatory agency during the review and approval of new products and make recommendations to the agency on how it could collaborate with the private sector to promote specific new products.

2. Financial institutions should inform their respective regulatory agencies about major new products that they intend to introduce. Discretion should be exercised in determining whether the product is significantly new or a minor refinement to existing products. Where in doubt, the regulatory agency should be consulted.

3. Financial institutions should be permitted to introduce the product if the regulatory agency has not raised objections to the product within 30 days of being informed of the product.

INTRODUCTION

This strategic plan has been prepared by the Financial Sector Consultative Committee (FSCC), a committee established by the Bank of Ghana as part of the Trade and Investment Reform Program (TIRP). TIRP has, as a primary objective, the promotion of participatory policy change that addresses key issues regarding macroeconomic, trade and investment policies, and the streamlining of the regulatory process to facilitate rapid growth in the economy.

The Inter-Ministerial Committee on Competitiveness (IMCC), which is chaired by the Minister of Finance, oversees TIRP. Other members of IMCC are the Bank of Ghana, Ministry of Trade and Industry, Ministry of Food and Agriculture, National Development Planning Commission and the Private Enterprise Foundation.

This strategic plan is for consideration and adoption by the IMCC. The FSCC has prepared the strategic plan after extensive consultation with regulatory agencies, financial institutions and other stakeholders of the financial system. This consultation was carried out through the deliberations of the FSCC and its two sub-committees: the Legal, Regulatory and Supervisory Sub-Committee and the Financial Intermediation Sub-Committee.

Under the Trade and Investment Reform Program, the Improved Policy Reform and Financial Intermediation project is designed to achieve two intermediate results:

- Fostering an improved policy and regulatory environment by creating a participatory policy change process; and
- Promoting improved financial intermediation to facilitate growth in the private sector.

The strategic plan is designed to provide a framework for attaining the objective of improved financial intermediation. A *National Action Plan* has been prepared as part of the strategic plan to guide relevant agencies on the steps that need to be taken to implement the recommendation embodied in the strategic plan.

VISION 2020: WHERE WE WANT TO GO

Ghana's long-term vision for socio-economic development has been articulated in the National Development Policy Framework, also known as Vision 2020. The long-term vision is that by the year 2020, Ghana will have achieved a balanced economy and a middle-income country status and standard of living. Attainment of middle-income status requires that economic growth rates rise from the present 4-5% annually to 8% annually.

A major improvement in the levels of investment and savings is required to achieve the results of Vision 2020. As envisaged at the initiation of the development strategy in 1995:

- Private investment was to rise from 11% of GDP to 16.5% of GDP, while total investment was to rise from 20% of GDP to 26% of GDP
- Domestic savings needed to rise from 2.7% of GDP in 1993 to 20% of GDP by 2000

Vision 2020 rightly recognizes that the savings rate in Ghana has been traditionally low. The poor performance of financial savings mobilization may be due to macroeconomic factors such as low levels of income. However, this is also partly due to industry-specific constraints such as an underdeveloped financial system as well as the lack of competition among and within the financial sector's main sub-sectors of banking, non-bank financial institutions, the securities industry, insurance, pensions and the formal and informal microfinance sector.

The constraints to financial sector development are addressed in this strategic plan. These constraints range from macro factors to institutional level constraints.

BASIC REQUIREMENTS FOR AN EFFECTIVE FINANCIAL SYSTEM

It is important to establish the attributes of an effective financial system. Indeed, to achieve the objectives of Vision 2020, Ghana's financial system has to increasingly reflect the attributes of an effective financial system.

There are three basic requirements for an effective financial system:

1) An effective financial system must have an efficient medium of exchange for exchanging goods and services. Such a medium of exchange serves as a unit of account. The medium of exchange needs to be universally accepted and its value must be reasonably stable if it is to be widely used. Finally, the medium of exchange should be a convenient means of paying for goods and services provided.

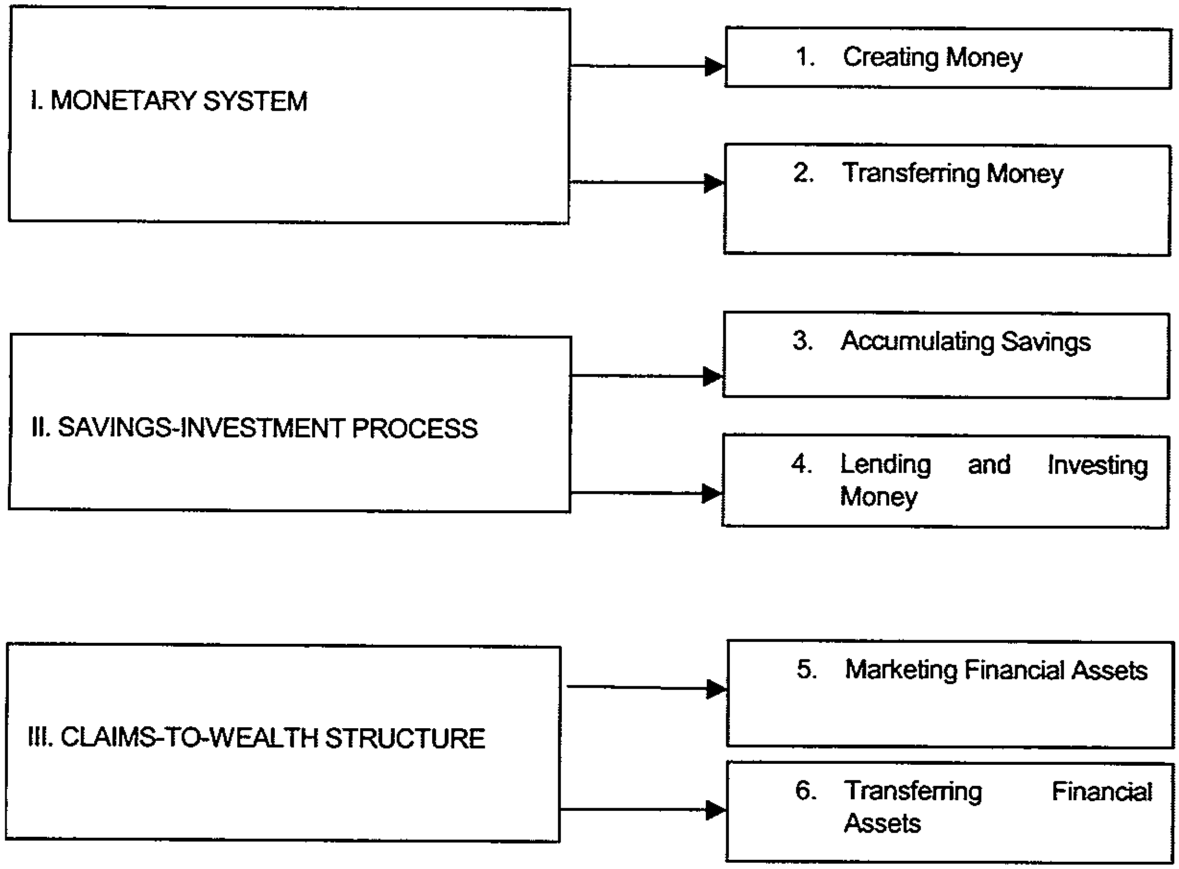
2) The financial system must make it possible for the creation of capital on a scale large enough to satisfy the needs of the economy. In a developed economy, capital formation takes place indirectly. Surplus spending units deposit their funds with financial intermediaries who in turn transfer the funds to deficit spending units. The process works well only if proper legal instruments and financial intermediaries exist.

3) An effective financial system provides markets for the transfer of financial assets such as stocks, bonds and shares and for the conversion of such assets into cash. Markets support capital formation by providing investors with opportunities to quickly convert their investments to cash.

A summary of the attributes of an effective financial system is presented in Figure 1. The three attributes of an effective financial system are depicted as the monetary system, savings-investment process and the claims-to-wealth structure.

A *financial market* is a market in which financial assets (securities), such as shares and bonds, can be purchased or sold. One party transfers funds to the financial market by purchasing a financial asset previously held by another party. Financial institutions serve the purpose of facilitating the accumulation and allocation of capital by channeling individual savings into loans to governments and businesses. The transactions of financial institutions thus consist of making loans to customers and the purchase of investment securities in the market place. Financial institutions also offer a wide variety of other financial services ranging from insurance protection to the sale of retirement plans and the provision of a mechanism for making payments, transferring funds and storing financial information.

Figure 1: Characteristics of an Effective Financial System



Because of the wide variety of services offered, there are several types of financial institutions. Table 1 provides a classification of financial institutions that recognizes both the source and the deployment of funds by each type of financial institution. Depository institutions raise funds by accepting deposits in the form of current, savings and fixed deposit accounts from households and businesses. Non-depository institutions raise funds either from other financial institutions or by selling securities in the financial markets. The typology presented in Table 1 is very general. Countries at different stages of development may not necessarily exhibit all the various types of financial institutions.

Financial institutions facilitate the attainment of the objectives of the financial system. The services provided by financial institutions include the following:

- Information Services
- Liquidity Services

- Price-Risk Reduction Services
- Transaction Services
- Maturity Intermediation Services

Table 1: Types of Financial Institutions
■ Depository Institutions
♦ Commercial Banks
♦ Merchant Banks
♦ Savings and Loan Companies
♦ Credit Unions
♦ Building Societies
♦ Discount Houses
■ Non-Depository Institutions
♦ Contractual Savings Institutions
■ Insurance Companies
■ Pension Funds
♦ Collective Investment Institutions
■ Mutual Funds
■ Unit Trusts
♦ Finance Companies
♦ Leasing Companies
♦ Securities Market Institutions
■ Investment Banking and Brokerage
■ Stock Exchanges

Financial institutions provide these services with an increasing degree of specialization as follows:

- Money supply transmission (banks)
- Credit allocation (banks, non-bank financial institutions)
- Intergenerational transfers (pension funds, life insurance companies)
- Payment services (banks)
- Denomination intermediation (mutual funds/unit trusts, pension funds)

Failure to provide these services or a breakdown in their efficient provision can be costly to the economy in terms output and employment. Because of the potential for contagious effects of financial institution failure, financial institutions are among the most regulated sectors of the economy. Six types of regulation seek to enhance the net social welfare benefits of financial intermediaries services. These are:

4) Prudential (safety and soundness) regulation – to protect depositors and borrowers against the risk of failure. This involves regulations on asset composition (e.g., prohibition from lending more that 10% of equity to a single borrower) and capital adequacy, provision of guarantee funds such as deposit insurance, and monitoring and surveillance

5) Monetary Policy Regulation

6) Credit Allocation Regulation

7) Consumer Protection Regulation

8) Investor Protection Regulation

9) Entry and Exit Regulation

Note that although regulation may be socially beneficial, it imposes costs and benefits for the regulated. For example, regulators may require more capital than the owners believe to be in their own best interest. The private costs of regulation include compliance costs for operators of financial institutions. The difference between the private benefits to a financial institution being regulated, such as deposit insurance, and the private costs it faces from adhering to regulation is called the *net regulatory burden.* Financial sector regulation in Ghana should be sensitive to the fact that the higher the net regulatory burden on financial institutions, the more inefficiently they produce any given set of financial services from a private owner's perspective.

HISTORICAL DEVELOPMENT OF GHANA'S FINANCIAL SYSTEM

Appendix A provides a chronological summary of major events in the financial development of Ghana. Financial markets in Ghana have evolved in fairly identifiable stages as follows:

10) The Colonial Era (up to 1960)

11) The Centrally Planned and Closed Economy Period (1960-83)

12) The Structural Adjustment and Transition Period (1983-1995)

13) The Vision 2020 Period (1995 to Present)

The Colonial Era

During the colonial era, the colonial government restricted itself to monetary stability, and monetary growth was tied to export performance. Banking was established with the object of providing banking services for the British trading enterprises and the British Colonial Administration. Between 1912-1957, the West African Currency Board functioned as a central bank, operating a Sterling Exchange Standard through a guaranteed convertibility of the West African pound to sterling. There were no exchange controls. The West African Currency Board did not have any central banking functions. It did not exercise control over the volume of currency or issue; nor could the Colonial Administration exercise any control over the currency supply. WACB operated as a bureau exchanging West African currency for sterling and vice versa and accounting for such activities. It invested its surpluses in approved sterling securities.

In evaluating the financial system of this era relative to the attributes of an effective financial system, we can make the following observations:

- The financial system played a passive and limited role in promoting economic development.
- The primary function of the financial system was to provide essential currency infrastructure. The system put in place led to the transformation of the colonial economy from a barter system to a modern currency system.
- There were virtually no non-bank financial institutions. While there were insurance companies, they were established by British companies, trading houses and banks to support their trade with the U.K. The focus of the industry was generally on commercial risk coverage. There was no life insurance industry.

In terms of the attributes of an effective financial system, this system only satisfies the first attribute, i.e., the need for an efficient medium of exchange or a monetary system.

Financial Markets and Institutions in a Planned and Closed Economy: 1960-83

In the immediate post-independence era, the government of Kwame Nkrumah adopted a socialist development strategy under which the state was to be predominant in all aspects of economic policymaking and implementation. This period was characterized by:

14) Import Licensing: A comprehensive system of import licensing was instituted in November 1961.

15) Exchange Controls: The Exchange Control Act of 1961 imposed all embracing exchange controls over the entire range of international transactions.

5) Quantitative restrictions on interest rates.

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6) Forced lending programs, including requirements for banks to lend to sectors of the economy that were considered priority sectors by the government.

The implementation of the provisions of the Exchange Control Act together with a system of import licensing moved Ghana significantly towards a closed economy.

Within the banking sector, the following developments were taking place:

16) The Bank of Ghana became the pivot of all international banking activities, whether these related to remittances, letters of credit, collections, allocation of foreign exchange, travel or tourism.

17) In response to the changing macroeconomic environment, the Bank of Ghana Act (1963) was passed. The Bank was required to submit a report to the government anytime the money supply growth exceeded 15% for any year, stating the reasons for such a rise and recommending measures to contain the associated inflationary pressures.

18) The Bank of Ghana was empowered to set ceilings on advances or investments by commercial banks and given powers to control the banking system.

19) New credit control measures were introduced in 1964 to control and direct the granting of credit to be in accordance with the government's economic policy.

Development Banks

In the early 1960s, the Bank of Ghana provided capital for the establishment of development banks, which were new banking institutions, created with clearly specified roles. This was a response to the feeling that commercial banks – with their policies of "borrowing short and lending short" were not suited to the task of mobilizing funds to finance medium and long-term investments. The following banks were incorporated to undertake the financing of specific projects in industry, agriculture, housing and merchant banking, respectively:

1) National Investment Bank, 1963 (Industry)

2) Agricultural Credit and Cooperative Bank, 1965 (Agriculture)

3) Bank for Housing and Construction, 1972 (Housing)

4) The Merchant Bank (1972) to offer one-stop corporate banking services. Its main functions were:

- Taking wholesale deposit of corporate funds
- Providing venture capital
- Term lending to the corporate sector
- Dealing in stocks and shares
- Financing of imports and exports
- Financial consultancy and advisory services

The development banks obtained long-term credit from the Bank of Ghana to support their lending operations. In addition, the Bank of Ghana provided credit guarantees to the banks to cover loans and advances to industrial and agricultural enterprises.

Rural Banking

In 1964, a rural credit department was established at the Bank of Ghana to devise appropriate methods for financing the agricultural sector in line with the seven-year development plan. By the 1970s, it had become evident that the Agricultural Development Bank, which was designed to provide a vehicle for reaching the small-scale farmer, did not have the capability to provide adequate rural coverage. This realization led to the establishment of a rural banking system, modeled on the rural banking system in the Philippines. The objective was to extend banking services to the rural areas by having a system of unit banks. The first rural bank was set up in 1976. By December 1987, there were 117 rural banks.

Non-Bank Financial Sector

The non-bank financial sector was relatively undeveloped. The State Insurance Corporation (SIC) was set up in 1962 and given a monopoly over the government sector. The National Trust Holding Company (NTHC) was established by legislative instrument in 1976 to operate as a national mutual fund. The objective was to use NTHC to support the government's indigenization programme. NTHC acquired the shares of foreign companies and sold them to Ghanaians in what was essentially an over-the-counter market, the first and only one of its kind in Ghana at the time.

The initial era of state banking was also a period of macroeconomic instability. The salient features of the financial system then were as follows:

- The state's domination of the banking industry was complete. The majority of banking institutions were either directly fully owned by the state or indirectly by agencies of the state.
- Nearly 70% of the credit granted by the banks were earmarked either to meet the Public Sector Borrowing Requirement (PSBR) or to satisfy the credit requirements of the state enterprises. Credit for the private sector was less than one-third of the total.
- By 1983, the large state-owned enterprises had run up large overdrafts, most of which had become non-performing with the state banking institutions.

In Ghana's case, evidence of financial repression was reflected in the following:

- The high inflation rate had eroded the capital base of most banks.
- Demand deposits constituted 64% of total deposits, thus constraining long-term lending.
- Controls on interest rates had resulted in negative real rates of interest. There were high levels of currency outside banks with the currency/deposit ratio peaking at 77% in 1983.
- A sharp depreciation in the domestic currency led to the creation of many unserviceable foreign loans administered by the banks.

In addition, due to excessive intervention by the government in the allocation of credit, the quality of credit assessment had deteriorated with undue concentration of credit in section sectors and individual hands. Management problems were pervasive, with fraud and insider abuse of a cheap credit system. In effect, all the norms for prudential lending and capital adequacy had been thrown out the window.

The financial system as it existed then did not satisfy the three attributes of an effective financial system. First, the high rate of inflation and the sharp depreciation in the domestic currency violated the requirement that the medium of exchange must be reasonably stable. In effect, the monetary system had become ineffective. In a repressed financial system, the second and third attributes of an effective financial system cannot be satisfied. Specifically, the savings-investment process that supported the accumulation of savings and their allocation to investment had broken down. Under the officially mandated credit allocation system, capital could not be allocated to the most productive projects. Finally, the need for a free transfer of financial assets (i.e., the claims-to-wealth structure) was undermined by official control of deposit and lending rates.

The Structural Adjustment (Transition) Period 1983-95

In 1983, the Government adopted an economic recovery program which included:

- Devaluation of the currency
- Dismantling of most price and distribution controls
- Elimination of many subsidies
- Broadening of the tax base
- Improvement of tax collection
- Restoration of macroeconomic balance by:
  - Development of the foreign exchange market to maintain a free and flexible rate
  - Fiscal policies designed to increase public savings
  - Monetary policies to reduce inflation

From 1987, there was a gradual liberalization of the financial system:

- All sectoral credit allocations were phased out, with the last target for agriculture abolished in 1990;
- Interest rate controls were gradually relaxed and full liberalization was achieved in February 1988;
- In November 1990, the Bank of Ghana decontrolled all bank charges and fees;
- A foreign exchange auction was introduced in 1986 and the establishment of forex bureaus was permitted in 1988.

Financial Sector Reform Programme 1988

By the late 1980s, the World Bank and the Ghana Government had agreed that a reform and restructuring of the financial system was indispensable to a successful economic recovery programme. With technical and financial assistance from the IDA, the government embarked upon a Financial Sector Reform Program in 1988. The objectives of the programme were:

- To undertake the restructuring of financially distressed banks;
- To enhance the soundness of the banking system through an improved regulatory and supervisory framework;
- To improve the mobilization and allocation of financial resources – including the development of money and capital markets; and
- To promote the development of non-bank financial institutions.

These objectives were supported by the IDA through a Financial Sector Adjustment Credit (FINSAC) of US$100 million.

FINSAC II (1989)

The second Financial Sector Adjustment Programme – known as FINSAC II – was launched in 1989. Its objectives were:

- To reduce state shareholding in Ghanaian banks;
- To continue the bank restructuring programme which was launched under FINSAC I;
- To intensify the recovery of non-performing loans by the Non-Performing Assets Recovery Trust; and
- To enhance the effectiveness of a broad range of non-bank financial institutions.

In line with the policy of liberalizing the financial sector by reducing the state's direct involvement in the banking system, the Government embarked on a policy of privatizing state-owned banks.

By 1990, the FINSAC programs were beginning to show results:

- Banks were meeting capital adequacy standards because of recapitalization and offloading of non-performing assets.
- The privatization of state-owned banks was underway. The Social Security Bank (SSB) was listed on the Ghana Stock Exchange in October 1995. Prior to that in 1994, another state-owned bank, the National Savings and Credit Bank had been merged with SSB.
- Ghana Commercial Bank, the largest of the state-owned banks, was listed on the Ghana Stock Exchange in May 1996.

Securitized Finance and The Ghana Stock Exchange

Until 1990, what was missing from Ghana's financial sector development was an active stock market. To the extent that there was a securities market, it was limited to government bills and bonds which were sold in a primary market. Secondary trading was limited. The establishment of the Ghana Stock Exchange in 1990 was a landmark event in the financial sector development of Ghana.

Stock markets affect economic activity through the creation of liquidity. Investors are reluctant to relinquish their savings for long periods of time. Liquid equity markets make investments less risky (and more attractive), since they allow savers to acquire an asset which they can sell quickly if they need access to their savings or want to alter their portfolios. At the same time, companies enjoy access to permanent capital raised through the equity markets. By facilitating longer-term more profitable investment, liquid markets improve the allocation of capital and enhance prospects for economic growth.

Evidence indicates that countries with both liquid stock markets and well-developed banks grow much faster than countries with both illiquid markets and undeveloped banks. However, greater stock market liquidity is associated with faster future growth regardless of the level of banking development. Similarly, greater banking development implies faster growth no matter what the level of stock market liquidity.

The most important legislation in this sector of the economy was enacted in 1993 as an umbrella legislation intended to cover all facets of the securities industry. Prior to the enactment of the Securities Industry Law, 1993 (PNDCL 333) [SIL], dealings in securities were unregulated unless the dealer was a company, in which case the Companies Code, 1963 (Act 179), applied; or the dealings occurred on the Ghana Stock Exchange where regulations have been enacted to regulate trading and the conduct of members of the Exchange.

The SIL provided for the establishment of a Securities Regulatory Commission (SRC) to serve as a watchdog over the industry. Its main functions include maintaining surveillance over the securities market to ensure orderly, fair and equitable dealings in securities; and to license and authorize stock exchanges, unit trusts and mutual funds and securities dealers and investment advisers. An important role of the SRC is the formulation of principles for the guidance of the industry and the creation of the necessary atmosphere for the orderly growth and development of the securities market. The Securities Regulatory Commission started operations in 1999, prior to which the Bank of Ghana exercised the regulatory powers under the SIL.

Non-Bank Financial Institutions

A significant area of change has been the rapid growth of non-bank financial institutions with the structural adjustment and liberalization of the economy. Since 1987, several non-bank financial institutions have been licensed as follows:

TYPE	NUMBER
Discount Houses	3
Finance Houses	12
Leasing and Hire Purchase Companies	5
Venture Capital Funds	1
Mortgage Finance Companies	1
Savings and Loan Companies	8
Stock Exchange	1
Stock Brokerage Companies	12

In 1993, the Financial Institutions (Non-Banking) Law was passed to provide a legal framework for a whole new set of financial institutions which were being established. These institutions included discount houses, finance houses, acceptance houses, building societies, leasing and venture capital companies.

The growth of the non-bank financial sector was given a significant boost in 1995, when the Government of Ghana, with the support of a $25 million IDA credit, developed a program to enhance the capacity of the non-bank financial sector. The Non-Bank Financial Institutions Assistance Credit (1995) addresses gaps in the large formal sector non-bank financial sector, including:

20) Capital Market Institutions (Ghana Stock Exchange, Securities Regulatory Commission and the Bank of Ghana NBFI Department).

21) The Contractual Savings Industry (National Insurance Commission, State Insurance Company, Ghana Reinsurance Organization, Social Security and National Insurance Trust).

22) Associated Financial Infrastructure (Domestic payments system, School of Administration of the University of Ghana, Institute of Chartered Accountants of Ghana, Home Finance Company).

In addition, diagnostic studies were to be undertaken at the Ministry of Finance to prepare strategies for future actions in the area of informal, rural and consumer finance.

THE CURRENT SITUATION: STRENGTHS AND WEAKNESSES

Strengths of Current Financial System

It is clear that Ghana's financial system has undergone dramatic restructuring during the last decade and a half. There is evidence that the reforms over that period have had a favourable impact. For example:

- The privatization of the banking sector is on course. Two banks have been privatized and listed on the Ghana Stock Exchange. Two insolvent banks, the Bank for Housing and Construction and the Ghana Cooperative Bank, have been liquidated. Only two banks that are still in the public domain - the Agricultural Development Bank and the National Investment Bank.
- The licensing of several new banks has increased competition in the banking sector.
- The pace of innovation has increased. The rate of computerization of the banking system has increased. Currently, several banks have automated teller machines (ATMs) and one bank has introduced a stored value card, the "Sika Card", an electronic purse which carries a fixed level of stored value on a card.
- New financial instruments are being introduced. Examples include:

◆ Asset-Backed Securities

◆ Dollar Denominated Bonds

◆ Dollar Indexed Bonds

- Regulation of financial institutions has improved significantly. This is reflected in a strengthened supervision of banks and non-bank financial institutions by the Bank of Ghana, a revamped National Insurance Commission and the establishment of the Securities Regulatory Commission.

Weaknesses of the Financial System

Reviewing the attributes of an effective financial system again, the system has the basic ingredients of what is needed to satisfy attributes 2 and 3, that is, the creation of capital on a large scale and the creation of a market for transferring financial assets. However, the rate of mobilization of funds is low and the existing financial market has limited capacity and liquidity. The monetary system (attribute 1) has also come under severe strain because of macroeconomic instability reflected in high and variable rates of money growth and inflation, high nominal interest rates, fluctuating real interest rates and an unstable exchange rate.

There continue to be a number of areas within the financial sector, which require further attention and support. The financial sector is small relative to the rest of Ghana's economy and financial depth, as measured by the ratio of M2 to GDP, is low in Ghana as compared to the fast growing developing countries, such as Malaysia and Thailand. There is a policy and regulatory drag. That is, the policy and regulatory agencies are slow to respond to new developments in the market. Capacity for innovation is much stronger in the private sector than in the public sector, with the latter thus slowing down the pace of change. More specific constraints on financial sector development are described below.

Regulation and Supervision

Consultative Process on Financial Sector Regulatory Matters

There is a widespread feeling that regulatory agencies need to improve the process of consultation with regulated institutions and other stakeholders of the financial sector. To the extent that there is consultation, it is currently limited to requests from regulatory agencies to regulated agencies for memoranda on proposed changes. The process does not allow for effective debate and involvement of other major stakeholders, such as individual and corporate users of financial services and service providers to financial institutions. Consequently, regulatory reform does not benefit from the widest possible range of experience. Furthermore, the weakness of the consultative process feeds mistrust between regulators and the regulated, with the latter increasingly becoming passive.

There is a need to develop a consultative culture within the financial sector. Presenters from the insurance industry attested to the significant improvement in consultation which has been achieved through forums convened by the National Insurance Commission during which serious efforts were made to forge a consensus on regulatory matters.

The implementation of a Financial Sector Strategy should be accompanied by the establishment of structures for monitoring the implementation of the strategy. Such a structure should provide for periodic reviews and update of the strategic plan to reflect new developments. Responsibility for implementation and monitoring should be clearly identified.

Operational Problems of Regulatory Agencies

The regulatory agencies face several operational problems. The key operational issues were identified as follows:

Lack of Operational Independence

The Basle Core Principles for Effective Banking Supervision state, among others, that an effective system of banking supervision will have the following characteristics:

1) Clear responsibilities and objectives for each agency involved in the supervision of banking organizations, with each such agency possessing operational independence and adequate resources.

2) The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set.

There is a widespread perception that regulatory agencies are not independent and are subjected to political pressure. The Bank of Ghana 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 the government in the licensing of banks, adjusting the minimum capital adequacy requirements, initiating action against and taking over distressed banks.

While the criteria for licensing banks have been set out, the criteria for other financial institutions are not transparent. Licensing decisions that are widely seen as biased fuel the perception of politicization.

Other Operational Issues

1) Low budgets and understaffing lead to long reaction times for regulatory agencies on matters of concern to the industry.

2) Lack of industry experience of staff of regulatory agencies leads to misunderstandings on regulatory issues.

3) Delays in getting regulatory approval of directors nominated for financial institutions. There has been a confusion of "security risk" (as applied by the Ministry of Interior for national security purposes) with suitability for directorship. Candidates are subjected to irrelevant and inappropriate questions that have nothing to do with "fit and proper" criteria for directorship. The delays and extensive information requirements have deterred many qualified people from serving as directors of financial institutions.

Regulatory Coordination

Convergence in financial markets has created financial services firms that operate in several financial sectors. In Ghana, many financial institutions operate across a number of regulatory jurisdictions. For example, many banks have brokerage and investment advisory subsidiaries (CAL Merchant Bank, Merchant Bank, First Atlantic Merchant Bank, Ecobank). Other financial institutions, such as CDH Financial Holdings, have subsidiaries in discount house operations, brokerage, investment advisory and insurance services.

Cross-selling of products is developing to a point where a financial institution would be able to sell to the same client banking, brokerage, fund management and insurance services. The current supervisory structure is functional regulation (banking authorities regulate banking subsidiaries, securities authorities regulate securities subsidiaries, etc.). Inadequate coordination or regulation could lead to:

1) Regulatory arbitrage where an operator can run afoul of regulations in one sector and continue to operate in another sector.

2) Cross-subsidization of operations can occur if regulators in the various product areas are unaware of each other's position with respect to a particular regulated institution.

3) Regulators may set rules that conflict with each other if there is inadequate coordination.

4) Developmental objectives of regulators may be in conflict. For example, the SRC may be promoting the development of capital market risk instruments while the NIC may be restricting their use by insurance companies as investments.

5) Duplication of efforts in activities such as the vetting of directors.

There are several models for regulatory coordination that could be considered. One extreme is the single regulator approach, such as the Financial Services Authority (UK), the Financial Services Board (South Africa) and the Superintendent of Financial Institutions in Canada. The presence of an umbrella supervisory body may facilitate a review of the financial institution as a whole and scrutiny of decision-making policies and internal controls at the highest level. The FSCC was also made aware of the Nigerian model where there is a Coordinating Committee of Regulators consisting of bank, insurance and securities industry regulators. A single-regulator approach is extreme and would require extensive study and preparation to adopt in Ghana. The optimal supervisory structure should combine the benefits of specialization inherent in the functional approach with some amount of coordination.

Registries

The registration procedure for charges by way of mortgages is cumbersome. There are no regional facilities for registering legal documents that back financial transactions. In addition, search mechanisms in the courts, Registrar-General and Land Registries are slow and cumbersome.

Delays in Debt Recoveries

There is too much delay in recovering debt from defaulters. This state of affairs adds to the cost of credit (reflected in the high spreads that lenders need to stay in business). In the extreme, delays in debt recovery may prevent credit from being extended with consequent negative effects on business investment. Further misallocation of credit might occur with lending being biased towards short-term credits backed by very liquid collateral.

Outdated Laws

Key legislation that underpins financial transactions is outdated, e.g.,

- The Companies Code
- The Bankruptcy Law
- The Exchange Control Act
- The Banking Law
- The Insurance Law
- The Financial Institutions (Non-Banking) Law
- The Bills of Exchange Act

Many laws include financial limits such as stated capital, security deposits and penalties that have become outdated because of inflation.

THE REGULATORY AND POLICY AGENCIES

National Insurance Commission

The National Insurance Commission has made tremendous progress in building a healthy insurance sector. However, there are still areas of concern.

1) The composition of the Commission needs to be reviewed. The Commission must be broadened to include a representative of the Ghana Insurance Brokers Association. While representatives of the Ghana Insurers Association, Insurance Institute of Ghana, Ghana Police Service, Ghana Private Road Transport Union and National Council on Women and Development are provided for on the Commission, the appointees serve at the pleasure of the Minister. For effective participation, the representatives of the respective organizations should take their seats automatically.

2) The Insurance Law (PNDCL 227, 1989) is outdated and does not cover adequately life and health insurance. A specific example is the definition of insurable interest, which does not reflect the peculiarities of our culture.

3) The intervention powers of NIC are inadequate. Currently, the law does not provide for the NIC to intervene early enough to avert failure in cases where there are indications that a company might be in trouble.

4) Offshore insurers are doing business in Ghana despite the current provision that an insurer or reinsurer shall utilize all available local capacity before recourse to overseas facultative reinsurance. However, there are no clear guidelines for enforcing this provision. There is a need to set up a National Retention Limit for all classes of insurance, keeping in view the prudential safeguards of national assets which international reinsurance provides.

5) The legal requirement for a minimum of 40% Ghanaian participation in insurance companies is of questionable merit. This in is view of the fact that Ghanaians may not be able to invest adequately to meet higher stated capital requirements.

Bank of Ghana

The Bank of Ghana faces operational constraints resulting from:

1) Inadequate human resource capacity for effective supervision. The effect of this is that there is a backlog of bank examinations. The need for additional investment in human resource capacity is more pressing considering that it takes five years to develop a bank examiner.

2) There is lack of library access to up-to-date resource materials.

Registrar-General

1) The Registrar-General's Department is constrained by lack of responsiveness of business legislation to the changing needs of the financial sector. For example, the Companies Code, 1963 has not been reviewed since its passage thirty-six years ago.

2) The Registrar-General's Department serves as the depository for incorporation records and annual returns of companies. However, the technology for storage and retrieval of records is woefully inadequate. Search times are long and often records cannot be traced.

3) There is no enforcement of the provisions in the Companies Code. Sanctions against non-compliance are not applied. Part of the reason for non-enforcement lies in weak logistics. However, in some cases the only recourse the Registrar-General may have is to go to court.

Ministry of Finance

The Ministry of Finance is not able to keep up with the pace of financial reform needed for improved financial intermediation and financial sector development.

SECTOR ISSUES

Insurance

1) The Insurance Law, PNDCL 227, 1989, as amended, still leaves monopoly in favour of state companies. This has become anachronistic given that there are now Ghanaian privately owned insurance and reinsurance companies.

2) The requirement for insurance companies to have the prior approval of the Commissioner of Insurance of investments is unduly restrictive. Under PNDCL 227, investment of insurance funds is restricted as follows:

Life Insurance

a). 50% in government securities

b). 50% in such investments as may be approved by the Commission.

Non-Life Insurance

a). 25% in Government Securities

b). 75% in such other investments as the Commission may approve.

The power to approve investments, as currently expressed legally, can be counterproductive by preventing an insurance company from taking timely and prudent investment decisions.

Banking

1) The definition of "banking' in PNDCL 225 is becoming ambiguous, given the changes in the financial sector. The law recognizes a distinction between commercial banks, merchant banks and development banks. This is reflected in differences in the capital requirements for each category of bank. However, in terms of actual activities, the distinction between commercial banks, merchant banks and development banks has become increasingly meaningless with all banks providing essentially the same services at the wholesale and retail level. In addition, other deposit based on institutions, such as savings and loans companies compete effectively with smaller banks in the same markets.

2) There is an inconsistency in the rules relating to the payment for goods and services in foreign currency in Ghana and the operation of foreign currency accounts. The Bank of Ghana has on several occasions reminded the public that under the Bank of Ghana Law 1992, PNDCL 291, the Exchange Control Act 1961 (Act 71) and the Exchange Control (Amendment Law), 1986, PNDCL 149, it is illegal for a person resident in Ghana to accept payment in foreign currency in Ghana for services rendered or for the sale of goods or property or as rent in respect of any property owned. At the same time, the Bank of Ghana has legalized the operation of two types of foreign accounts that can be held as current accounts in local banks. These are Foreign Currency Accounts and Foreign Exchange Accounts. The former is an account to hold foreign remittances only and is credited with funds from foreign sources only. The latter account is for foreign currency sourced from within Ghana and such funds are not supposed to be readily transferable outside Ghana. Both accounts may, however, be operated as transaction balances with cheque writing privileges. Such cheques are negotiable in Ghana and thus are used to effect payment in foreign currency within Ghana.

Non-Bank Financial Institutions

Statutorily, NBFIs in Ghana are covered by the Financial Institutions (Non-Banking) Law, PNDCL 328, 1993, which identifies nine specific types of NBFIs: Discount Houses, Finance Houses, Acceptance Houses, Building Societies, Leasing and Hire Purchase Companies, Ventures Capital Funding Companies, Mortgage Financing Companies, Savings and Loan Companies and Credit Unions. This statutory definition includes institutions whose economic functions are bank-like, such as discount houses, building societies, savings and loan companies and credit unions.

The key features of the NBFI Law are as follows:

1) BOG is the designated licensing and regulating agency for NBFIs, with executive powers to prescribe rules and regulations for general or specific application.

2) Capital Requirements: Minimum NBFI capital requirements are set at ¢100 million.

3) Prudential Regulations: The minimum capital adequacy ratio is set at 10 percent of risk assets and the Bank of Ghana (BOG) has the power to prescribe the minimum level of liquid assets. Exposure limits are set at 15 percent of net worth for secured advances and 10 percent for unsecured advances.

4) Some NBFIs can invite deposits from the general public, but only for fixed periods. NBFIs cannot offer checking deposit facilities.

Reporting requirements under the law include:

- Notification of the Bank of Ghana on changes in principal place of business within 21 days of such change,

- Bank of Ghana approval for a change of name,

- Filing of changes in regulations and directors,
- Quarterly returns filed with the Bank of Ghana,
- Submission of audited accounts to Bank of Ghana.

The NBFIs identified the following issues:

1) Burdensome regulation, including requirements to file weekly interest rates and annual business plans.

2) Proposed increases in stated capital might be too high.

3) The schedule to PNDCL 228 needs to be reviewed. There are some financial institutions whose inclusion on the schedule of NBFIs to be regulated is questionable. NBFIs that have been mentioned in this context are venture capital firms and leasing and hire purchase companies.

The Securities Industry

The Ghana Stock Exchange started with 3 Licensed Dealing Members (LDMs) in 1990. Currently, it has 12 LDMs. By any standard, this has been a rapidly growing industry. Unfortunately, the growth has been uneven. Only a handful of firms have had a significant impact on the market. The record of the industry indicates the following:

- The Exchange has 22 listings of equities and four corporate bonds.
- The last Initial Public Offer (IPO) occurred in July 1999. Prior to that there had been no public issue for 2 years.
- Of the 9 IPOs, the placements of 5 did not realize the targeted amount of funds. A further analysis of the IPOs indicated that the actual amount of fresh capital raised is relatively insignificant. In many cases, such as AGC and Ghana Commercial Bank, the IPOs involved an offloading of shares held by the Government with relatively little capital going to the companies involved for real investment. For GCB, the IPO involved a divestment of 60% of Government ownership, while the SSB flotation was a divestment of 60% of shares held by SSNIT. Since the GSE started operations, the total value of new listings has been ¢151.4 billion. Of this amount, only 30% represented fresh capital raised for business investment – an indication of a relatively weak intermediation by the investment banking industry. The capital raised by companies for investment in the economy has been low indicating that there is much to do to build a vibrant investment banking industry in Ghana with a significant economic role.
- Latest brokerage markets share statistics indicate that the top 3 firms do 50% of market volumes. In fact, the top two firms do about 45% of the market.
- Only about 4 LDMs have research departments, with the number of analysts being in the region of a total of 10;
- Only 6 firms have either led or co-managed a new issue. These are NTHC, Databank, Merban, Strategic African Securities, EBG Stockbrokers and CDH Securities.
- Only one equity IPO has been fully underwritten.

Key issues in the securities industry are:

1) Need to increase listings through government incentives. This could take the form of a lower corporate tax rate for listed companies or a generous first year tax deduction for initial public offers. There were concerns raised about the possibility that other groups of firms may line up

for special tax incentives as well. For this reason, some prefer a one-time tax allowance for IPO costs.

2) There is an asymmetry in the tax treatment of investment income. While interest income is tax-exempt, dividends are taxed at a withholding rate of 10%.

3) The market lacks pooled investment schemes, which could be attractive to small investors who would like to participate in a diversified and well-managed fund.

4) Although non-resident investors can deal in securities listed on the exchange without obtaining prior exchange control permission, there are some restrictions on portfolio investors not resident in Ghana. The current limits on all types of non-resident investor holdings (be they institutional or individual) are as follows: a single investor (i.e., one who is not a Ghanaian and who lives outside the country) is allowed to hold up to 10% of every company's shares. Secondly, for every listed company, foreign investors may hold up to a cumulative total of 74% (in special circumstances, this limit may be waived). The limit excluded trades in shares of Ashanti Goldfields and soon to be listed Produce Buying Company.

5) The Securities Industry Law lags behind developments in the industry. For example, the SIL does not recognize derivatives directly. Derivatives can only be brought under the law if the Minister of Finance declared them as securities by notice in the gazette. An opportunity to broaden the definition of securities in line with market trends was lost in the current amendments to the law before Parliament. In much the same style of lagging the market, the proposed Unit Trusts and Mutual Fund Regulations prohibit investments in futures contracts by a mutual fund or unit trust. Another prohibition that does not reflect modern market practice is the prohibition of short selling.

SSNIT

The pension fund as a financial intermediary exists to bridge the gap between rising desired expenditures for most, following retirement and the abrupt decline in income at retirement. This gap is closed, at least partially, by the accumulation of funds (savings) during the working years of an individual's lifetime (through both employer and employee contributions) and the investment of those funds in a portfolio of financial assets (stocks and bonds) and sometimes in real assets (such as real estate). With large contributions from participants in the early years and with relatively few retirees to draw the funds out, pension funds can grow at an enormous rate at the early stages. With such a rapid growth, large pension funds invest heavily in the capital markets, thus transferring the retirement savings of individuals to business and governments for real investment. The pension fund has one of the most stable sources of funds of all financial intermediaries. Inflows and outflows are highly predictable. The extreme stability of sources of funds, coupled with the fact that a pension fund's time horizon is very long, means that pension funds are not active in short-term investments. Most of their investments are in capital market instruments.

There are no private pension schemes in Ghana. There is a mandatory contribution of 17.5% of salary to the Social Security and National Insurance Trust (SSNIT), 12½% by the employer and 5% by the employee. SSNIT is a statutory body governed by the 1991 Social Security Law. It is charged with the responsibility for collecting social security contributions and making social security payments.

SSNIT's investments are mainly in Government of Ghana Treasury Bills and Bonds and real estate. Investments in private sector companies and shares listed on the Ghana Stock Exchange are a relatively small proportion of SSNIT assets. Thus, despite being the largest single source of long-term contractual savings in Ghana, SSNIT has not been able to significantly increase the supply of long-term capital to the private sector.

While SSNIT has not done much to stimulate securities markets, it has been instrumental in promoting several new financial institutions, such as the Home Finance Company, Ghana Venture

Capital Fund, Export Finance Company, and Securities Discount House. By purchasing long-term bonds indexed to inflation, SSNIT has assisted Home Finance in securing a long-term source of funds for mortgage lending.

The dominant position of SSNIT and the absence of a tax-deductible status for private pensions has deterred the emergence of private pension funds and stifled competition in the sector that could have improved savings mobilization. Because the SSNIT contribution is mandatory, SSNIT does not have to actively compete for members and has earned low returns and sustained high operating costs.

The benefits of private pension plans are as follows:

- They induce increased savings by workers
- They create a solid base of domestic institutional investors
- They channel fund contributions into private investment by taking positions in the equity and long-term debts issues of private sector firms
- They encourage efficiency in both pension administration and investment management.

Financial Intermediation Issues

There are a number of constraints of a general nature that constrain financial intermediation in Ghana. They include:

- High inflation and interest rate environment
- Market volatility and uncertainty
- Absence of a credit information system
- Lack of market confidence in interest rates because of deep-seated perception that Bank of Ghana interferes in the auction process
- Lack of a long-term debt market
- Limited secondary market for government debt
- Inadequate financial innovation

Market Environment

High inflation works against long-term investment since investors are worried about maintaining the real purchasing power of capital. The market is also characterized by a high degree of volatility. The following data are instructive:

		1995	1996	1997	1998	1999
1	Interbank Exchange Rate (Year End (¢/US $)	1445	1740	2250	2346	3440
2	% Cedi Depreciation	-25.6	-17.0	-22.7	-4.1	-31.8
3	Year-on-Year Rate of Inflation (%)	57.5	46.6	27.9	19.3	13.8
4	GSE All-Share Index (%) Change	6.3	13.8	41.9	69.7	-15.2

The volatility of the financial market indicators adds to the perceived risk of engaging in financial transactions.

Interest Rates and Government Debt Market

There is a widespread perception that the treasury bill auction conducted by the Bank of Ghana is not a clean auction. It is widely believed that the Bank of Ghana always has a reservation price and does not accept bids that fall below the reservation price. Although there is no direct evidence of manipulation of the auction to achieve a pre-determined rate, many members have expressed surprise that the interest rate could be that stable if the auction was a clean auction.

The Head of Treasury of the Bank of Ghana has denied that the Bank of Ghana was fixing the Treasury Bill rates. Rather, the Bank has been surprised that the bidders consistently stuck to the same bids week after week, even in the face of changing liquidity conditions in the market. This suggests that the perception of a predetermined auction might be the lack of understanding of the auction procedure.

Credit Information System

A necessary condition for an efficient financial system is that there should be readily accessible information about participants in the system. The absence of such information creates moral hazard and adverse selection costs that can cause credit markets to fail. Market failure is reflected in the unwillingness of lenders to extend credit at any price. Creditworthy borrowers are shut out of the market.

Moral hazard arises from the inability of a lender to observe the actions of a borrower after credit has been extended. Adverse selection occurs because borrowers have more information about themselves than the lender and are unwilling to reveal negative information about themselves. Lenders who are uncomfortable about how much they know about the borrower, therefore, will not extend credit.

In economies with advanced credit markets, a significant investment has been made in building an infrastructure for collecting, storing and retrieving information about participants in the financial system, as reflected in the widespread existence of credit bureaus that maintain information. A starting point for a credit information system is the availability of systems for identifying participants in the market. The absence of such an identification system in Ghana has been a major factor in the low level of credit market development.

The basic building blocks for an identification system already exist in the current Social Security Number, which underpins the SSNIT pension scheme. A universal adoption of the Social Security Number would provide the basis for a credit information system. Additionally, databases of important registries, such as the land registries, could be based on the Social Security Number to facilitate collection, storage and retrieval.

The FSCC recognizes that widespread information about individuals could fan fears about loss of privacy. The adoption of Social Security Numbers should, therefore, be accompanied by guidelines on how information may be transferred amongst financial institutions and between financial institutions and other organizations.

An important part of a credit information system is the availability of credit bureaus, credit reference service and rating agencies. One of the main components of the Private Enterprise and Export Development Project funded by IDA is the establishment of a Credit Reference Agency (CRA) in Ghana. In this connection, a consortium, composed of Sterling International Group Inc. and Dun & Bradstreet Information Services, was commissioned to study the feasibility of establishing a CRA in Ghana. The feasibility study established the need for and potential viability of a CRA. The CRA, when established, will offer a full range of credit reference and rating services to Ghanaian and foreign entities interested in obtaining general and creditworthiness information on Ghanaian companies. This will be done through the issue of business information and background on the existence of the business and its financial statements.

Progress towards the establishment of a Credit Reference Agency has been slow. Part of the reason is that the Bank of Ghana has been unable to attract enough equity investors to participate in the project. A further weakness in the proposed Credit Reference Agency is that it does not provide for a Credit Bureau, where information can be kept about all individual and corporate borrowers. Neither does the project provide for a rating agency that will support the issue of corporate debt instruments.

While plans seem to be far advanced for the establishment of a Credit Reference Agency, the laws are vague on whether the information needed to operate the Credit Reference Agency can be divulged. There is a need to clarify the law and establish an appropriate legal framework.

Fund Management Industry

The benefit of having a fund management industry is the intensification of competition in the financial system. The development of new sources of finance from non-bank financial intermediaries, such as pension funds and mutual funds, forces dominant banks to become more competitive and to start searching out their customers, rather than waiting for prospective borrowers to visit them.

The development of a fund management industry also fosters competitive bidding for issues of securities. The greater availability of financial resources encourages companies to place new issues directly with fund managers. Fund managers also support the growth of venture capital funds and the provision of private equity, both of which help finance new and expanding smaller firms.

Financial Innovation

There is a widespread perception that the rate of innovation in the financial sector is slow. A guiding principle for promoting financial innovation is that such innovations should be *demand-driven* by the requirements of the private sector and should be the outgrowth of the pursuit of profitable new processes and products by financial institutions. The role of government should be restricted to one of providing a conducive environment for the private sector to make sound choices within the context of a financial system that meets the test of effective regulation.

The principle that financial innovations should be market-driven with government providing a facilitating role still leaves a lot of room for government leadership in financial innovation. Indeed, many financial innovations in Ghana have come about through public-private partnership. An example of government leadership in financial innovation was the establishment of the Ghana Stock Exchange in 1990. In this instance, the government took the lead in mobilizing the private sector and international technical assistance to support the establishment of the stock exchange. Other examples of such public-private partnerships include:

1. The Ghana Futures Exchange, which has already moved from the idea stage to a pre-feasibility report conducted by the Ghana Stock Exchange and the Bank of Ghana and a National Workshop conducted in 1999.

2. The Credit Reference Agency being promoted as a public-private partnership by the Bank of Ghana.

3. A Currency Forward Market, promoted by the Bank of Ghana.

Experience in such public-private partnerships indicates that they are effective, where they have been applied. The approach could be made more consistent by institutionalizing it among all regulatory agencies.

The issue. of whether financial institutions wishing to introduce new products need to seek regulatory approval before launching new products is a challenging one. From an industry perspective, if all new products have to be approved by regulatory agencies before their introduction, it would stifle innovation because the amount of time regulatory agencies would need to understand the product can be costly to the innovator. First, financial institutions invest resources to develop and launch new products which means that they need to make a return on their investment. The uncertainty as to whether or not regulatory approval would be obtained and the timeliness of such decisions can discourage financial institutions from making the decision to invest in the development of a new product. Secondly, extensive delays in the regulatory process expose the financial institutions to changes in the marketplace that might adversely affect the introduction of the product. Finally, financial institutions are concerned about the leakage of information on products they have developed to their competitors, the risk of which increases the longer the product stays with the regulatory agency.

A further complication with requiring prior regulatory approval is that many so-called new products are, on closer examination, just refinements to existing products. New products might be created by extracting and combining features of a number of existing products and repackaging them as a new product. An example is a hybrid bank account, such as the "Meridian Gold" account, which was both a current account with full cheque-writing privileges and also a savings account which paid interest, subject to the maintenance of a minimum balance. Thus, some new products have such familiar features that a formal regulatory review adds no value to the financial system and may, in fact, deter innovation.

SECTOR ISSUES

The Banking Sector

The banking sector is characterized by

1) Excessive market concentration.

2) A low level of savings.

3) A high level of currency outside the banking system.

4) A payments system that is inadequate to support the settlement of financial transactions.

5) Excessive foreign exchange risk exposure.

6) High cost of financial intermediation reflected in high spread between borrowing and lending rates.

The Securities Industry

The securities industry faces the following constraints:

1) No credit rating agency to support development of a debt market.

2) No long term debt instruments.

3) Inadequate knowledge of the securities industry by public officials.

4) Small number of listed companies reflected in an insufficient number of capital market instruments.

5) High flotation costs which are a disincentive for small companies to list.

Discount Houses and the Money Market

The first discount house in Ghana, Consolidated Discount House, was established in 1987; a second discount house, Securities Discount Company, was incorporated in 1990 and started operations in 1991. More recently, the Fidelity Discount House commenced operations in 1998.

At inception, the discount houses in Ghana were expected to fulfill the following functions:

1) Taking very short-term deposits from banks and thereby supplying them with highly liquid assets;

2) Discounting commercial bills of exchange and thereby supplying industry and commerce with short-dated funds;

3) Underwriting the weekly tender for Treasury Bills;

4) Making a market for short-dated bills of the financial system.

In return for performing the above functions, call money placed by banks with discount houses qualify as first-line liquid assets for satisfying the secondary reserve requirement. This privilege enables discount houses to mobilize funds at low cost.

Discount houses in Ghana face several challenges. Several new developments have taken place since the inception of discount houses in Ghana, which have had the net effect of weakening the market position of the discount houses. Over the past few years, Bank of Ghana policy and operational procedures have drifted in the direction of relying on the money markets to conduct their monetary policy operations without recourse to discount houses as intermediaries.

This is reflected in:

1) The emergence of a primary dealership system for Treasury Bills, with the discount house being only one of several primary dealers.

2) The establishment of an active REPO market in Ghana, with the BOG engaging in REPO activity directly with the banks.

3) Overdrawn operational balances at the Bank of Ghana are charged rates which are more favourable relative to rates charged to discount houses, undercutting the ability of discount houses to pass on their high costs of borrowing at the Bank of Ghana to banks who call on the discount houses for funds.

In addition, the emergence of an interbank market, which actively competes with discount houses for overnight funds, has strengthened the ability of the banks to manage their liquidity without recourse to the discount houses. The interbank market has had an important effect on how the money market works. Since banks have the lowest cost of funds, the interbank borrowing is much cheaper than funds obtained by issuing Negotiable Certificates of Deposit to a discount house or by rediscounting bills.

It is clear that the regulatory authorities have not come to terms with the fundamental policy question of the long-term role of discount houses in the money market. The policy choices are very clear. Discount houses are intermediaries between the central bank and the banking institutions. The intermediary role is reflected in the fact that the central bank provides liquidity to the financial system by lending to the discount house, which in turn lends to the banks. In many countries, central banks have chosen to use a more direct approach by lending directly to the banking system. What is of interest is that countries, whose money markets revolved around discount houses, have, over time, been transformed into non-discount house based systems. These countries include Singapore, UK, Malaysia and South Africa. Ghana has to come to terms with the same policy question sooner or later.

Countries that have made successful transitions out of the discount house model are those countries whose discount markets had developed into active secondary markets. Regardless of the future role assigned to discount houses, government policy has to move in the direction of facilitating the development of the discount houses into active dealers in government securities.

SSNIT

SSNIT is a major player in the financial market because it controls one of the largest pools of savings in Ghana. The management of the pool of savings will have a significant impact on the allocation of capital within the economy. Given that SSNIT may not have the in-house capacity to effectively manage the large pool of pension funds, it should take advantage of investment management capacity in the private sector by partially outsourcing its investment management.

Microfinance

Microfinance is the provision of financial services (credit and savings) to a large number of micro, small and medium scale entrepreneurs, the productive, but resource poor, including women, in a cost-effective manner. The ability to access small cushions of savings and even buy or invest in small amounts of insurance can make a radical difference in the lives of individuals formerly lacking access to such services. The microfinance industry consists of Micro-Finance Institutions (MFIs) as providers of financial services. The government, including the Bank of Ghana, plays a major role in the sector as policy designer, regulator and supervisor. Donors are also active in this sector as providers of development funds and technical assistance.

Microfinance institutions can be formal, semi-formal and informal. Formal MFIs include 133 Rural Banks, 200 Credit Unions, 8 Savings and Loan companies and some commercial and development banks (notably, the Agricultural Development Bank, Ghana Commercial Bank and Social Security Bank). Servicing small-scale cocoa and food-crop farmers, as well as fishermen, is a thrust of the Agricultural Development Bank. The semi-formal MFIs are the numerous "*Susu*" and *Susu* clubs which are prevalent in and around market places. This informal system operates on the basis of daily deposits by customers, with a monthly return of cash, less a day's deposit for the services of the *susu* collector. The key informal MFIs are Rotating Savings and Credit Associations (ROSCAs) and moneylenders, on whom information is very scanty.

The major constraints facing the microfinance sector are as follows:

Formal Microfinance Institutions (Rural Banks, Savings & Loan Companies, Credit Unions)

4) Weak financial performance. Management productivity as measured by loans-to-assets ratio is low. Credit and delinquency management is a problem.

5) Weak governance and management.

6) Low outreach and penetration.

7) Ineffective supervision and regulation.

Semi-Formal/Informal Institutions

1) Low public trust due to non-regulation.

2) Little or no interest on deposits.

3) Little or no wholesaling of credit by banks to *Susus*.

4) High *susu* fees/commissions.

OPPORTUNITIES, THREATS AND STRATEGIC OPTIONS FOR FINANCIAL SECTOR DEVELOPMENT

In reviewing national strategic options for financial sector development, we should take into consideration issues of competitiveness of Ghana's economy in general and more specifically, the financial sector. The following regional developments should be of concern as we map out a financial sector strategy:

1) Ghana's financial competitiveness is threatened by the recent opening of the Regional Stock Exchange in Abidjan. The stock exchange caters for the eight countries of the UMOEA region. Traders across the regional exchange are linked by satellite to the trading floor in Abidjan where all trades are centrally executed. The regional stock exchange means that there are now three stock exchanges in the ECOWAS region, Ghana, Nigeria and the Regional Exchange. Of the three exchanges, the Ghana Stock Exchange is the smallest in terms of listings and market capitalization. Technologically, Nigeria and the regional exchange are way ahead of Ghana. Unless steps are taken to improve our competitiveness, foreign portfolio capital will bypass Ghana for Abidjan and Nigeria.

2) The weak currency of Ghana makes Ghana financially uncompetitive, given that it is surrounded by countries of the CFA zone. Recent efforts to create a second monetary zone in the ECOWAS region are a step in the right direction, although the convergence rules may not be that easy to achieve.

3) Ghana's linkage to global financial markets is weak. In particular, the lack of a sovereign rating and access to international financial markets make it difficult for the private sector to access international capital markets.

4) The concept of a Gateway has not been articulated in financial terms. We have not fully articulated the implication of the gateway strategy for the financial sector. Strategic options, such as offshore banking possibilities which could complement the free zones and gateway strategy, have not been investigated.

A developing country like Ghana has to face decisions about how to craft the outlines of a rapidly changing financial sector. An appreciation of the differences in financial systems around the world and their relative benefits and costs would be helpful. There are strong indications that financial markets everywhere are moving towards convergence. As part of this convergence, banks are free to conduct both investment and commercial banking activities (including active investment in firms) and corporate securities markets are unhindered by regulatory and legal obstacles. Systems which have traditionally been dependent primarily on bank finance, such as Japan and Germany, are changing rapidly to increase the role of securities markets in corporate finance. The U.S. environment, in which securities markets have traditionally dominated, is changing to allow banks to be more active participants in all aspects of the financial system.

Regulatory and policy agencies need to position themselves for the inevitable convergence of financial services during the next 5-10 years. The Bank of Ghana, National Insurance Commission and the Securities Regulatory commission need to take a proactive stance by developing an "*Industry Development Framework*" to be coordinated by the Ministry of Finance, working in consultation with the National Development Planning Commission. The *Industry Development*

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A SCENARIO FOR FINANCIAL SECTOR CONVERGENCE								
YEAR	Payment Services	Savings Products	Lending		Underwriting: Issuance of		Insurance and Risk Management Products	Fiduciary Services
			Business	Consumers	Debt	Equity		
1980								
Depository Institutions	X	X	X	X				X
Leasing/Hire Purchase								
Insurance Companies							X	X
Finance Companies								
Mortgage Finance								
Securities Firms								
Mutual Funds								
Pension Funds								
Microfinance Institutions								
2000								
Depository Institutions	X	X	X	X				+
Leasing/Hire Purchase			X				X	
Insurance Companies		X		X				
Finance Companies			X					
Mortgage Finance				X				
Securities Firms		X		X	X	X		X
Mutual Funds								
Pension Funds		X						X
Microfinance Institutions		X						
2010								
Depository Institutions	X	X	X	X	X	X	+	X
Leasing/Hire Purchase			X					
Insurance Companies		X		X	X	X	X	X
Finance Companies		X	X	X				
Mortgage Finance			X	X				X
Securities Firms		X		X	X	X	X	X
Mutual Funds	X	X			X	X		X
Pension Funds		X			X	X		X
Microfinance Institutions	X	X	X	X				

+ Selected involvement via affiliates

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Framework should be updated regularly and fed into the strategic planning of each regulatory agency. The planning process of regulatory agency should be structured to anticipate industry developments and provide for appropriate regulatory adjustments and capacity needs consistent with industry trends.

A GRAND STRATEGY FOR THE FINANCIAL SECTOR

The above analysis indicates that the development of the financial sector has to be placed in the context of overall national development plans and must respond to the issues of Ghana's competitiveness within a regional and global setting. In this respect, national strategy for the financial sector should be guided by the following:

1) Leadership within the ECOWAS region achieved through financial innovation, support for financial institutions to expand regionally in the ECOWAS region and integration of financial sector development with the Gateway Project by making Ghana an internationally recognized financial centre.

2) Integration with the global financial system by raising the standards of financial practice to accord with international best practice. This would include commitment to achieving international standards as promulgated by the Basle Committee on Banking Supervision, the International Association of Securities Organizations, and the International Federation of Stock Exchanges.

3) A cornerstone of national strategy should be the ultimate goal of a sovereign rating and sovereign access to the global capital markets to pave the way for Ghana's private sector to enter international markets.

4) The promotion of financial innovation through a facilitating environment and public-private partnerships. Regulatory agencies should create structures for seeking out innovations and adapting their regulations to support such innovations.

SPECIFIC STRATEGIES AND ACTION PLANS

Legal, Regulatory and Supervisory Recommendations

General Recommendations

Consultative Process on Financial Sector Regulatory Matters

1) The Financial Sector Consultative Committee should be institutionalized to serve as a permanent consultative forum on financial sector issues. To achieve this result, resources should be sought to support the work of the Committee on an ongoing basis.

2) FSCC should be given the mandate to sponsor an Annual Financial Markets Conference to bring together all stakeholders in the financial sector to review progress on the implementation of the Financial Sector Strategic Plan and bring the most up-to-date knowledge and experience to bear on updating the strategic plan.

3) Regulators proposing regulatory changes should hold open forums to discuss the proposals. Such forums should include not only regulated institutions, but also individual and corporate users of financial services, service providers (accountants, auditors, consultants, lawyers) and experts who can add value to the process. The major regulatory changes underway, such as the revisions to the Banking Law, the Financial Institutions (Non-Banking) Law, operating guidelines for NBFIs and regulations for collective investment schemes, should be subjected to the process of open forums.

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Management of Industry Development

1) Ministry of Finance should coordinate the preparation of *Industry Development Framework* papers by the Bank of Ghana, National Insurance Commission and the Securities Regulatory Commission for banking/non-bank financial, insurance and securities industry, respectively. Each framework paper should capture the likely course of development of the industry over a 5-10 year period and identify the regulatory and institutional changes that would be required. Periodically, the framework document should be updated.

2) Each regulatory agency should use the *Industry Development Framework* as input into its institutional planning.

Operational Problems of Regulatory Agencies

1) The Bank of Ghana 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.

2) Government needs to respect the independence of regulator and avoid direct and indirect intervention in the regulatory process. Minimizing discretionary powers of regulatory agencies and emphasizing formal rules and procedures so that regulatory decisions can be seen to be careful, deliberate and unbiased can reinforce this. All regulatory agencies should establish clear and transparent criteria for licensing of financial institutions.

3) Regulators should make a conscious effort to improve their understanding of financial industry by:

- Attaching staff to regulated institutions
- Recruiting from industry

4) Financial autonomy of regulatory agencies should be promoted through adequate charges to regulated organizations and other users of the services of regulatory agencies.

5) As resources permit, regulatory agencies should step up computerization of operations.

6) Vetting of directors should focus on suitability for directorship (e.g., lack of criminal record) not "security". Questions and forms to be used in conducting security checks for proposed directors should be in line with "best international practice", that are appropriate for establishing, in an efficient and timely manner, whether candidates are fit and proper. Regulatory agencies should maintain a common database of approved and rejected directorship nominees of financial institutions.

Regulatory Coordination

1) A permanent National Committee of Financial Regulators (NCFR), consisting of Bank of Ghana (Bank and Non-Bank Supervision), National Insurance Commission and the Securities Regulatory Commission, should be established.

2) Among others, the Committee should review major regulatory changes for mutual consistency before such changes are passed.

3) The Committee should establish common requirements for directors of financial institutions and oversee an effort to establish a database of directors of all financial institutions so that the long process of vetting of directors can be shortened. Directors who are nominated and already in the common database may then be approved without going through an extensive second vetting.

4) Pending the creation of a directors' database, information on directors should be shared by regulatory agencies.

Registries

1) Registries should be given financial autonomy so that they can apply user charges to upgrade their storage and retrieval technology.

Delays in Debt Recovery

1) Specialized commercial courts should be set up to handle debt recovery.

2) Adjudicating tribunals should be set up to handle dispute settlement in various industries (e.g., insurance, banking, brokerage).

Outdated Laws

1) A programme should be initiated to review and update the laws that govern financial sector activities. These include:

- The Companies Code
- The Bankruptcy Law
- The Exchange Control Act
- The Banking Law
- The Insurance Law
- The Financial Institutions (Non-Banking) Law
- The Bills of Exchange Act

2) Financial limits should be removed from laws. Regulatory agencies should be empowered to promulgate limits after consultations with the appropriate ministry and other stakeholders.

Agency-Specific Recommendations

Bank of Ghana

Strengthen human resource capacity of Bank of Ghana.

Registrar-General

1) Comprehensive review of the Companies Code should be initiated with a view to having a new Companies Code in place by the end of year 2002.

2) A process should be initiated to make the Registrar-General's Department financially autonomous within two years. The process would enable the agency to fund service improvements through reliance on its own revenues from user charges, rather than the Consolidated Fund.

3) Fees charged by the Registrar-General's Department should be reviewed to ensure that they are adequate to support and improve operations.

Ministry of Finance

Strengthen institutional capacity of the Ministry of Finance.

Sector Recommendations

Insurance

1) The Government/NIC should remove the monopoly given to state-owned insurance companies.

2) The requirement for the Commissioner's prior approval for investments should be reviewed. Insurance companies should have more flexibility in selecting investments within reasonable prudential guidelines.

Banking

1) Bank of Ghana should review coverage of "banking" to cater for an expanding banking sector.

2) There is a need to reconcile the inconsistencies in the policy on the settlement of transactions in Ghana in foreign currency and the operation of local foreign exchange accounts.

Non-Bank Financial Institutions

1) Review the schedule to NBFI law.

2) Review reporting requirements to ensure that all filings are necessary.

The Securities Industry

1) Provide a one-time incentive to companies that list on the stock exchange through a generous tax allowance for IPO flotation costs.

2) Level the playing field on taxation by exempting dividends from tax.

3) Pursue rapid passage of amendments to the Securities Industry Law.

4) Restrictions on foreign participation in Ghana's stock market should be eliminated.

5) The SRC needs to strike a proper balance between market development and regulation. In general, outright prohibitions should be avoided as they stifle financial innovation. The law should be flexible to allow introduction of new instruments. The process can be managed by imposing rules on use of new instruments for prudential reasons and for investor protection.

SSNIT

1) The government should accelerate the introduction supplementary pensions such as:

- Group supplementary plans
- Individual supplementary plans

2) The tax laws should be amended to provide equal treatment for supplementary pension schemes, with tax-deductible contributions up to a maximum of 25% of earnings, 17.5% of which would go to SSNIT.

3) An appropriate regulatory framework for pension schemes must be established to cover their operations.

Credit Reference Agency

1) Review the legal framework as regards to the establishment and operating of credit reference agencies.

Financial Intermediation Recommendations

General Recommendations

1) The Bank of Ghana needs to increase its investment in public information and education in order to dispel the widespread perception of interference in the Treasury Bill auction.

Fund Management Industry

1) There should be a partial outsourcing of the management of SSNIT funds.

2) Government should promote private pension funds.

3) SRC should accelerate development of collective investment schemes.

4) NIC should liberalize rules for insurance company investments within prudential guidelines.

Credit Information System

1) Bank of Ghana should accelerate the establishment of the Credit Reference Agency by outsourcing the equity placement to a private sector investment/merchant banking outfit.

2) The proposed CRA should collaborate with the Association of Banks on the development and use of the borrowers database, which is being developed by the Association.

3) The Bank of Ghana, the Securities Regulatory Commission and the National Insurance Commission should mandate the use of the Social Security Number for all financial sector transactions (banking, brokerage and insurance) as part of prudential requirements. The adoption of Social Security Numbers should be coordinated with SSNIT to ensure that identification numbers would be issued to all who need one.

4) Business users of financial services should be identified by the Taxpayer Identification Number (TIN)

5) Public education should be put in place to allay fears about loss of privacy.

Financial Innovation

A balanced approach that promotes innovation within reasonable prudential guidelines should be adopted.

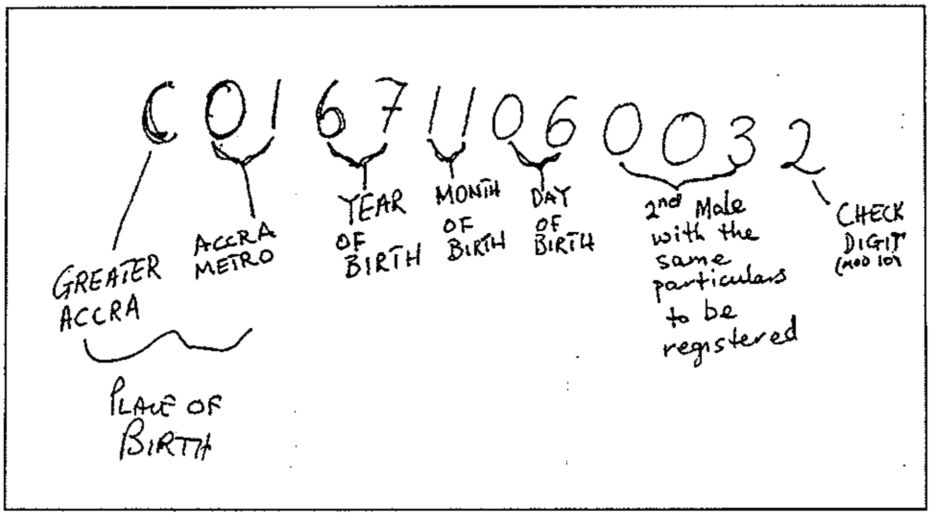
1) The Bank of Ghana, Securities Regulatory Commission and National Insurance Commission should appoint of a *New Products Officer* to research emerging new products both in Ghana and internationally and to advise the respective regulatory agency on appropriate regulatory adjustments to accommodate such products. The New Products Officer should provide technical support to the regulatory agency during the review and approval of new products and

make recommendations to the agency on how it could collaborate with the private sector to promote specific new products.

2) Financial institutions should inform their respective regulatory agencies about major new products that they intend to introduce. Discretion should be exercised in determining whether the product represents significantly new or minor refinements to existing products. Where in doubt, the regulatory agency should be consulted.

3) Financial institutions should be permitted to introduce the product if the regulatory agency has not raised objections to the product within 30 days of being informed of the product.

GHANA SOCIAL SECURITY NUMBER



Features of 13-Digit SSN

- **Region of Birth**
- **District of Birth**
- **Year/Month/Day of Birth**
- **Unique number for the individual**
- **Check digit**

Sector Recommendations

The Banking Sector

1) The Bank of Ghana should foster greater competition by requiring banks to publish and display banking charges, interest rates and commissions, and to give adequate notice when changes are being made to the schedule of fees.

2) The Association of Bankers should sponsor broader public education about activities of banks.

3) Steps should be taken to improve the effectiveness of cheques as a payment mechanism.

- Efforts of the National Payments Council to bring rural banks, credit unions and savings and loan companies into the payments system should be intensified.

- Government should set an example by ensuring that government cheques are not returned unpaid for whatever reason.

- The banking industry should explore possibilities outside the legal system for sanctioning habitual writers of dud cheques (including higher charges, sponsoring private sector cheque verification companies, etc.)

4) Net foreign exchange risk exposure should be set depending on bank strength.

Securities Industry.

1) Build capacity of public officials through public education campaign.

2) The market needs a medium-term government debt instrument to provide a benchmark interest rate and extend the yield curve. The bond should be properly structured to correct the liquidity weakness of the GSE Commemorative Stock which failed.

3) Bank of Ghana should undertake a study on the feasibility of issuing inflation-indexed bonds.

4) Tax incentives should be created for companies wishing to list on the Ghana Stock Exchange.

Discount Houses

Discount houses must be given the market flexibility to adapt their operations to changing environment. The requirement that 70% of their investment should be in government paper should be lowered to enable discount houses to play a more active intermediation role.

SSNIT

1) Outsource funds to professional fund managers. This would support the development of a fund management industry and improve the efficiency of capital allocation.

2) Outsource corporate lending to financial institutions by providing wholesale funds.

Microfinance

1) Rural Banks

- Develop stringent rating system to identify strong rural banks.

- Strongest rural banks should be integrated into the national banking system through interlinkages.

- Reserve requirements should be aligned with those of banks and other deposit-taking financial institutions, with appropriate supplementary requirements.

- Stricter enforcement of corrective measures and penalties for non-compliance with sound banking practices.

2) Credit Unions/Savings and Loan Companies

- Reserve requirements should be aligned with those of banks, with supplementary requirements if necessary.
- Promote capacity-building programs for CUA and Savings and Loan Companies.

3) *Susu* Collectors

- All *susu* collectors should be registered.
- Strengthen national and regional associations so that they can be self-regulating.
- Link largest *susus* with formal financial institutions.

NATIONAL ACTION PLAN

Objective: Improved Regulatory Consultation			
Tasks	**Responsible Institution**	**Target Completion Date**	**Measure of Performance**
1. Present proposal for implementation of the Financial Sector Strategic Plan including the future role of the FSCC.	Bank of Ghana	1 September 2000	• Proposal to IMCC • Budget established for FSCC
2. Hold public forum on proposed Banking Act	Bank of Ghana	To be determined by BOG	Public Forum held. Draft legislation revised to accommodate input.
3. Hold public forum on draft regulations for mutual funds/unit trusts	Bank of Ghana	30 September, 2000	Public Forum held. Draft legislation revised to accommodate input
4. Present proposals for 2001 Financial Markets Conference	Bank of Ghana	30 September 2000	Conference agenda and date confirmed.
Objective: Review and Update Outdated Legislation			
The Companies Code, 1963	Ministry of Justice/Registrar-General	1 January 2003	New Companies Code in place.
The Insurance Law	Ministry of Finance/NIC	1 June, 2001	New law promulgated
The Bankruptcy Law	Ministry of Justice	1 June 2001	New law promulgated
The Exchange Control Act	Ministry of Finance/Bank of Ghana	1 January 2001	New law promulgated
The Financial Institutions (Non-Banking) Law	Bank of Ghana	1 January 2001	New law promulgated
The Bills of Exchange Act	Ministry of Finance/Bank of Ghana	1 January 2001	New law promulgated

Objective: Improved Regulatory Coordination			
Tasks	**Responsible Institution**	**Target Completion Date**	**Measure of Performance**
1. Set up National Committee of Financial Regulators (NCFR)	Ministry of Finance	1 September, 2000	▪ Terms of reference adopted ▪ Committee set up ▪ Secretariat designated ▪ Short-, medium and long-term plan adopted
2. Establish common standards for the vetting of Directors of financial institutions	NCFR	1 January 2001	Common standard established
3. Establish common database of directors of financial institutions	NCFR	1 January 2001	Database in place
1. Revise questionnaires for vetting of directors	BoG, SRC, NIC, NCFR	1 January 2001	New questionnaire adopted
Objective: Improved Efficiency of Registries			
1. Financial autonomy for land, court and company registries	Ministry of Finance	31 December 2002	Registries given financial autonomy
Objective: Improved Debt Recovery			
1. Set up specialized commercial courts	Ministry of Finance/Judicial Council	1 January 2002	Court established
2. Set up Adjudicating Tribunals	Ministry of Finance/Judicial Council	1 January 2002	Adjudicating Tribunals established
Objective: Improve Efficiency and Competitiveness of Insurance Industry			
1. Establish guidelines for local retention of reinsurance	NIC	1 January 2001	Guidelines in place
2. Establish guidelines for insurance company investments	NIC	1 January 2001	Guidelines in place

Objective: Promote Growth of Securities Industry			
Tasks	**Responsible Institution**	**Target Completion Date**	**Measure of Performance**
1. Establish incentive for companies to list on the Ghana Stock Exchange	Ministry of Finance	1 January, 2001	Tax incentive in place
2. Level playing field by exempting dividends from taxation	Ministry of Finance	1 January, 2001	Tax exemption in place
3. Repeal restrictions on foreign participation on the Ghana Stock Exchange	Bank of Ghana	1 January, 2001	New rules in place
4. Issue one 3-Year and 5-Year bond annually to provide benchmark interest rate and extend yield curve	Bank of Ghana	1 January, 2001	New bond issued
Objective: Promote Supplementary Pension Schemes and Fund Management Industry			
1. Amend laws to give tax deductible status to private pension contributions	Ministry of Finance	15 June, 2001	Law amended
2. Partially outsource management of SSNIT funds	SSNIT	15 July, 2001	SSNIT fund management partially outsourced
3. Pass amendments to SIL and Regulations for Mutual Funds/Unit Trusts	SRC	1 September, 2001	▪ Law passed ▪ Regula[illegible]mulgated
Objective: Establish Credit Information System			
1. Mandate use of Social Security Number and Taxpayer Identification Number for all financial transactions	BOG, NIC, SRC	1 January, 2001	Bank, brokerage and insurance customers fully identified by SSN and TIN
2. Credit Reference Agency	Bank of Ghana	1 January, 2001	Credit Reference Agency operational
Objective: Promote Financial Innovation			
1. Appoint New Products Officer	BOG, NIC, SRC	1 January, 2001	Appointment made

ANNEX A: Financial Sector Consultative Committee

1. Teresa Ntim, Bank of Ghana (Chairperson)
2. Kwame Aboagye, SEM Financial Group Limited
3. William Adote, Ministry of Finance
4. Yeboa Amoa, Ghana Stock Exchange
5. Felix Y. Biga, Social Security and National Insurance Trust
6. Jesse Clottey, Private Enterprise Foundation
7. Nyamikeh Kyiamah, National Insurance Commission
8. D.K. Mensah, Ghana Association of Bankers
9. Fred Nuer, Association of Stockbrokers
10. Mark Owusuansah, Ministry of Finance
11. Eudora Quartey, Securities Regulatory Commission
12. Jay Salkin, Sigma One Corporation
13. Nii Kwaku Sowa, Centre for Policy Analysis
14. Wilson Tei, Ghana Insurers Association
15. Adu A. Antwi, Securities Regulatory Commission

Legal, Regulatory and Supervisory Sub-Committee

1. Jacob Arko Saah, Registrar-General's Department (Chairperson)
2. Mahmoud Hantour, Ghana Association of Bankers
3. Eudora Quartey, Securities Regulatory Commission
4. Joe Aboagye Debrah, Ghana Stock Exchange
5. Jay Salkin, Sigma One Corporation
6. Wilson Tei, Ghana Insurers Association
7. Charles Obeng Inkoom, Chartered Institute of Bankers
8. Jojo Acquah, Deloitte & Touche
9. Paul Asimenu, Ministry of Finance
10. Emma Ocran, National Insurance Commission
11. Adu A. Antwi, Securities Regulatory Commission
12. Daniel O.K. Owusu, Bank of Ghana
13. Kofi Amoa-Awuah, Bank of Ghana
14. Fred Nuer, Association of Stockbrokers
15. Tony Osei, Centre for Policy Analysis

Financial Intermediation Sub-Committee

1. Wilson Tei, Ghana Insurers Association (Chairperson)
2. Kwame Aboagye, SEM Financial Group Limited
3. Felix Y. Biga, Social security and National Insurance Trust
4. Jesse Clottey, Private Enterprise Foundation
5. Fred Nuer, Association of Stockbrokers
6. Mark Owusuansah, Ministry of Finance
7. Jay Salkin, Sigma One Corporation
8. Nii Kwaku Sowa, Centre for Policy Analysis
9. I. Owusu Hemeng, Chartered Institute of Bankers
10. Joseph K. Forson, Deloitte & Touche
11. Ekow Afedzie, Ghana Stock Exchange
12. Abraham K. Boateng, National Insurance Commission

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13. Grace Akrofi, Bank of Ghana
14. Adu A. Antwi, Securities Regulatory Commission
15. Alexis F.K. Anning, AFTECH Limited.

Secretariat

Sam Mensah, SEM International Associates, Financial Economist/Consultant
Sharon Dankwa, Bank of Ghana
Johnson P. Asiama, Bank of Ghana

ANNEX B: A CHRONOLOGY OF FINANCIAL MARKET DEVELOPMENTS

DATE	EVENT
1953	Bank of the Gold Coast (now Ghana Commercial Bank) established.
1961	Promulgation of Exchange Control Act which puts the inflow and outflow of foreign exchange under Bank of Ghana regulation.
1963	National Investment Bank set up to provide medium and long-term finance for the promotion of industrial, commercial, agricultural and other enterprises.
1965	Agricultural Development Bank set up.
1972	Bank for Housing and Construction set up to promote housing and civil engineering projects.
1972	Merchant Bank Ghana Limited Established. This was the first merchant bank in Ghana.
1983	Ghana launches World Bank/IMF-backed Structural Adjustment Program.
1985	Financial Sector Adjustment Program (FINSAP) launched.
September 1986	A weekly foreign exchange auction system was introduced.
1986(September)	A two-tier exchange rate system was adopted. The Window 1 rate was fixed at ¢90/US$ while the Window 2 rate was determined at the weekly foreign exchange auction.
1987	FINSAC I launched.
September	Maximum lending rates and minimum deposit rates decontrolled.
October	Weekly auction of Treasury Bills introduced.
November	Consolidated Discount House starts operations.
1988	The two foreign exchange windows were unified. Window 1 was abolished and the marginal rate established at the weekly auction became the rate for transactions for the week. Bank of Ghana could now authorize dealers other than banks to set up Bureaux de Change to buy and sell currency.
February	Minimum bank savings rate decontrolled. Sectoral credit controls, except for agriculture, removed.
April	Foreign exchange bureaus established.
September	90-day Bank of Ghana Bills for banks introduced.
1989 July	Comprehensive restructuring plan for banks adopted.
August	Banking Law PNDCL 225 passed. The law covered capital adequacy, reserve requirements, loan limits and reporting requirements. The new banking law strengthened the Bank of Ghana's supervisory role, including: a) periodic on-site examination of banks, b) regular standard reporting, c) issuance of new accounting standards, d) audit guidelines and e) authority to impose fines and punitive actions in case of violations.
September	Insurance Law enacted.
December	Non-rediscountable, medium-term Bank of Ghana instruments for banks with 180 day, 1 year and 2-year maturities introduced.
1990	Ecobank (Ghana) Limited established. Ecobank is a subsidiary of Ecobank International Limited. The parent holds 58% of the shares while a number of institutions and individuals resident in Ghana hold the remaining 42%.
January	New managers for public sector banks appointed; two new merchant banks

	licensed.
March	Bank cash reserve requirements on demand, savings and time deposits unified.
May	Restructuring of three state-owned banks begun; SOE non-performing loans swapped with Bank of Ghana FINSAP bonds.
September	NPART and the Non-Performing Assets Tribunal created.
November	Ghana Stock Exchange Commences operations; 30-day BOG Bills and 180-Day, 1 and 2 year treasury bills introduced; 5 Year Government Stock introduced; BOG instruments made available to the non-bank sector; lending targets for the agricultural sector and prescribed bank charges and fees abolished; cash reserve ratio reduced to 22%; secondary reserves ratio increased to 20%; bank restructuring extended to three additional banks.
December	Payment of interest on cash reserves at 3% introduced; private sector non-performing loans of state-owned banks swapped with BOG-issued FINSAP bonds; capital adequacy standards enforced.
1991 March	Private sector non-performing loans in sound banks swapped for non-issued FINSAP bonds.
June	Securities Discount House Commences operations.
July	Cash reserve ratio reduced to 18%; secondary reserve ratio increased to 24% and remuneration on cash reserves increased to 5%.
1992 January	Leasing company licensed.
October	Bank of Ghana Law (PNDC Law 291) providing for tougher supervisory and regulatory powers enacted.
1993 March	Cash reserve ratio reduced to 10%; secondary reserve ratio increased to 32%
May	Financial Institutions (Non-Banking) Law, PNDCL 328, enacted to provide the supervisory and regulatory framework for non-bank financial institutions and to encourage competition among commercial banks; Home Finance Mortgage Law enacted to support development of housing finance.
June	Finance Lease Law enacted to further the development of the leasing industry.
September	Cash reserve ratio reduced to 5%; temporary additional 15% secondary reserve ratio imposed, bringing secondary reserve ratio up to 65%.
1993	Securities Industry Law, PNDCL333, promulgated.
1994 May	National Savings and Credit Bank merged with Social Security Bank.
August	Approval granted for 3 new banks; approval granted for new leasing company.
1995 January	Changes in payment arrangements for inter-bank dealings introduced by BOG.
February	Appointment of advisor for the partial divestiture of SSB.
March	Appointment of advisor for the partial divestiture of GCB.
April	Appointment of advisors for the partial divestiture of NIB.
October	SSB listed on the Ghana Stock Exchange.
December	Bank of Ghana notice BG/GOV/SEC/95/29 – 11/12/95 "Remedial measures at GSE". Foreigners' participation in listed stocks permitted after the stock has been offered to the Ghanaian public for three consecutive days.
1996 May	Ghana Commercial Bank listed on the Ghana Stock Exchange.
1997 March	Minimum cash reserve fort banks set at 8% of total deposit liabilities (inclusive of foreign currency deposits); minimum secondary reserve

	reduced to 35% of total deposit liabilities (inclusive of foreign currency deposits)
1997 September	Bank of Ghana introduces Swap Deal Transaction
1998 June	Bank of Ghana introduces Book Entry System for issue of Government Treasury Bills.
1998 June	Bank of Ghana Repurchase Agreements introduced
2000	Amalgamated Bank starts operations
2000	Bank for Housing and Construction, National Cooperative Bank liquidated