CONTINENTAL SEMINAR OF THE ASSOCIATION OF THE AFRICAN CENTRAL BANKS ON THE THEME "FINANCIAL STABILITY: NEW CHALLENGES FOR CENTRAL BANKS"

Cairo, Egypt, 9 - 11 May 2016

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CONCLUSIONS AND RECOMMENDATIONS

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1. INTRODUCTION

The 2016 continental seminar of the Association of African Central Banks (AACB) was held on 9 - 11 May, 2016 in Cairo, Egypt, on the theme "Financial stability: New Challenges for Central Banks". Sixty delegates from nineteen member Central Banks and five regional institutions attended the seminar.

The opening ceremony was chaired by Mr. Tarek Amer, Governor of the Central Bank of Egypt, in the presence of Mrs. Leila Mokaddem, Resident Representative at the African Development Bank (ADB).

In his opening remarks, the Executive Secretary of the Association of African Central Banks, on behalf of the President of the AACB, Mr. Lucas Abaga Nchama, Governor of the Banque des Etats de l'Afrique Centrale (BEAC)[1], expressed his deep gratitude to the Governor of the Central Bank of Egypt for agreeing to host this seminar and exerting every possible effort to ensure smooth arrangements. He respectfully thanked the President, the Government and the people of the Arab Republic of Egypt for the warm and friendly welcome extended to the participants

He welcomed the remarkable participation of Central Banks, members of the AACB, and African and international institutions, which demonstrates their commitment to contributing decisively to addressing the challenges facing the monetary integration in Africa.

He pointed out that the 2016 Continental Seminar, on the theme "Financial Stability: New Challenges for Central Banks" takes place at a time where most African countries have not been directly affected by the international financial crisis, because of their low

[1] Bank of Central African States (BCAS)

interconnection to the global financial system. However, he noted that the growing importance of financial flows to Africa, under the effects of both the easing of monetary conditions at the global level and the improved macroeconomic performance of the continent, will necessitate to take this situation into consideration given the outcomes of the recent financial crisis.

2. OPENING CEREMONY

Mr. Tarek Amer, Governor of the Central Bank of Egypt (CBE), chaired the ceremony and delivered the opening speech. He highlighted the importance of exchanging ideas and sharing experiences in Africa to address the numerous challenges that the central banks face, including the challenge of achieving financial stability. In the light of the recent international financial crisis, central banks need to resort to innovation when it comes to tackling poor economic conditions.

In this regard, the Central Bank of Egypt today has several objectives related to inflation, consumption, employment and financial stability, instead of a single objective of price stability. The Governor of the Central Bank of Egypt noted that the Egyptian economic growth was mainly driven by consumption, which reflects the need to increase the supply of products in order to avoid imbalances that could lead to increasing the imports of goods and services and put pressure on the foreign reserves.

As regards the financial crisis, he urged the central banks to adopt the appropriate policies, especially innovative measures. However, he stressed the need for coordination between the monetary policy and the other elements of the economic policy, so as to avoid any potential conflicts that might arise. He also emphasized the need for central banks to restore the confidence of the public and the market.

Finally, the Governor of the Central Bank of Egypt invited governments to establish independent regulators and strengthen relations among African states, in order to preserve and strengthen financial stability.

3. STRUCTURE OF THE SEMINAR

The events of the Seminar went as follows: Experts first presented three sub-themes. Afterwards, the representatives of the central banks shared their experiences as regards the central theme of the Seminar. Finally, three break-out sessions were held to discuss selected issues, reflecting on the actions to be taken by the African Central Banks to preserve the financial stability in Africa amid the accelerating global capital inflows, financial innovations, and illicit financial flows. These deliberations allowed drafting the recommendations.

3.1. Plenary session 1: objectives, micro and macro prudential instruments, institutional arrangements, issues and challenges of financial stability amid financial innovations and the expansion of cross border banking activities

3.1.1. Mrs. Hala Amer, General Manager, Department of Banking Supervision at the Central Bank of Egypt, gave a presentation on "Issues pertaining to the implementation of macroprudential tools." She noted that macroprudential tools should help reduce the effects of systemic risk in terms of time and scale. She highlighted the instruments of the counter cycle policy related to the measurement of capital, credit and liquidity. To ensure macroeconomic stability, it is necessary to implement macroprudential instruments in order to allow complementarity between, on the one hand, macroprudential policy and monetary policy, and on the other, the macroprudential policy and microprudential policy, due to interactions among these policies.

3.1.2. Mr. Norman Mataruka, Director, Bank Supervision Division at the Reserve Bank of Zimbabwe, discussed "Perspectives and Challenges of cross-border banking activities in Africa." He noted that cross-border banking activities have increased considerably in recent years, due to the growing number of pan-African banking groups. The creation of cross border banks has not only increased competition and deeply entrenched the financial sector, but also acted as a development factor of international financial flows. However, these banks carry along financial risks due to their interconnection among countries. In order to avoid the threat posed by those banks as regards the stability of the African financial system, challenges remain that have to be dealt with. These include promoting the exchange of financial information among national banking supervisors in different countries that host these banks, and establishing joint supervisors committees to strengthen the assessment capability of the potential risks that could be induced by the activities of cross-border banks.

3.1.3. Dr. Charles Abuka, Director of Financial Stability, Bank of Uganda gave a presentation on "Opportunities and Challenges / Risks Posed by Emerging Trends in Financial Inclusion." He emphasized the importance of financial inclusion with respect to displaying the opportunities it offers, especially in combating poverty in Africa. He noted that the promotion of financial inclusion has helped reduce inequalities in sub-Saharan Africa, promoting the access to several basic financial services. Despite these benefits, financial inclusion can have other impacts on the effectiveness of monetary policies and financial stability, particularly due to its effect on interest rates and the risk of counterparty failure. When it comes to the interactions between promoting financial inclusion and monetary policy, several measures should be put in place, including a legal and regulatory framework, which would enhance the effectiveness of the monetary policy and protect the consumers.

3.2. Plenary session 2: Experiences of AACB Sub-regions' central banks

Eight central banks from different sub-regions presented their experiences, which are related to the central theme of the seminar.

4. <u>BREAK-OUT SESSIONS</u>

Following the presentations of the central banks' experiences in different sub-regions, the delegates were divided into three break-out sessions and exchanged views on the following topics:

- **Break-out session I:** Financial stability in Africa amid accelerating global capital inflows, financial innovations, and illicit financial flows: what steps can Central Banks take?
- **Break-out session II:** Issues, challenges and strategies for safeguarding financial stability in a context of expanding cross border banking activities and promoting financial inclusion.
- **Break-out session III**: Institutional & Regulatory Frameworks for Safeguarding Financial Stability in Africa: State of the Art, Advantages and Limitations.

Break-out Session I: Financial Stability in Africa amid accelerating global capital inflows, financial innovations, and illicit financial flows: what steps can central banks take?

Key observations:

1. In appraising the need for financial system stability, some member countries in the group confirmed that their banking sector accounts for the largest share of the entire financial system.

2. The financial system continues to play a critical role in the growth and development of most African economies, given that it is the main channel for capital mobilization for both the public and private sectors and also serves as the channel for implementing the central banks monetary policy.

3. The group identified certain fundamental conditions necessary for the attainment and sustenance of financial system stability in most African countries. These include but not limited to: the analytical capacity and competencies of the central banks to detect early warning signals; appropriate legal and institutional framework; strong corporate governance structures; effective coordination and collaboration among fiscal, monetary and financial sector policies; the availability of a robust and efficient payment system infrastructure; and the availability of accurate, reliable and timely data.

4. It was observed that the challenges of accelerated foreign capital inflows to most African economies are generally the same and most commonly include: appreciation of domestic currencies; loss of competitiveness; capital flow reversal; asset price volatility; and distortions in domestic prices and trade balances.

5. The group debated the global drive for financial innovation and sophistication against the structure and regulatory capacity of most African monetary authorities. Some key challenges were common to most African economies which included that: regulations lag behind financial innovations in most countries; vulnerability of consumers and investors to high risk derivatives not well understood; rapid build-up of concentration risks; and the over manipulation of financial data and concealments of relevant data.

6. The implications of illicit financial flows to most member countries were discussed and most members agreed that key challenges included: weak implementation of AML/CFT regulations, particularly adherence to "KYC" rules; the large proportion of the informal sector in most countries leading to the increasing activities of shadow banking – unregulated; and the prevalence of regulatory loopholes and monitoring gaps.

Recommendations

Following from the above observations and the peculiar experiences of the various member countries shared during the discussions, the group made the following recommendations:

1. The central banks and other regulatory authorities need to further strengthen prudential oversights and regulations within the financial system taking into consideration new innovations, emerging risks and the prevailing regulatory framework.

2. The regulators should develop robust framework for the continual improvement in capacities and skills for the detection of early warning signals and the development of Early Warning System (EWS) for the financial sector.

3. The central banks should provide leadership in driving good corporate governance culture and transparency in the conduct of the activities of the financial system by both the regulators and operators.

4. Member countries should take appropriate measures to apply and implement statutory AML/CFT rules in conformity with the global standards and conventions – including the development of country-specific initiatives to address the unique characteristics of member countries.

5. Member country monetary authorities should develop in collaboration with relevant stakeholders, a dynamic, efficient and effective foreign capital flow management framework that minimizes the distortionary consequences of capital flows.

6. Macro prudential regulations and surveillance should be strengthened in the supervision of the banking system and broadened to include other sectors of the financial system.

7. The regulators should evolve a proactive policy framework to address crisis management and resolution issues in the financial system, including regular review of regulatory limits and prudential thresholds.

8. Member countries should enhance the coordination and harmonization of monetary, fiscal and financial sector policies towards the achievement of financial system stability and economic growth.

9. Member countries should put more effort to encourage and support the availability and accessibility of reliable, accurate and granular data for the appraisal and review of financial system indicators and instruments.

Break-out Session II: Issues, challenges and strategies for safeguarding financial stability in a context of expanding cross border banking activities and promoting financial inclusion

Key Observations

Cross-border Banking & Financial Stability

1. Cross-border banking has become an increasingly important feature of the African financial landscape in the past decade.

2. The integration of financial markets and financial infrastructures in the African region, together with the growing number of cross-border operations, contributes to the efficiency and stability of the African financial system. At the same time, financial integration increases the scope for cross-border banking and thus the likelihood of a systemic crisis affecting more than one country.

3. Cross-border banking and the associated financial interconnectedness has brought about a number of challenges as follows:

    a) challenges with supervision of financial conglomerates;

    b) money laundering issues;

    c) opaque and complex structures;

    d) regulatory arbitrage;

    e) differences in legal frameworks across jurisdictions;

    f) lack of coordination during bank crisis; and

    g) contagion and systemic risk.

4. While there has been growing importance and use of Memoranda of Understanding (MoUs) for information sharing arrangements, much less thought has been given to cross-border arrangements on crisis management.

Financial Inclusion & Financial Stability

5. The expansion of financial services to all sections of society (financial inclusion) is important for economic growth and development.

6. Increased financial inclusion has significant implications for monetary policy and financial stability which are policy areas that reside at the very core of central banking.

7. Group members observed that despite efforts to enhance financial inclusion, many sections of the African population remain unbanked.

8. Group members also observed that some of the financial systems in Africa do not provide a wide range of financial services such as credit, savings, payments, transfers, pensions, capital markets and insurance to the marginalised members of the society.

Recommendations

Cross-border Banking & Financial Stability

1. There is need for member central banks to harmonise regulatory and supervisory norms as well as accounting standards through convergence to internationally accepted standards and practices including the Basel Core Principles for Effective Bank Supervision, International Financial Reporting Standards (IFRS), anti-money laundering standards, Basel recommendations on consolidated supervision and risk-based supervision.

2. There is need for member central banks to enhance MoUs to incorporate crisis resolution of cross-border entities by clearly spelling out common principles, procedures and practical arrangements concerning cooperation during a financial crisis and ensure that the MoU is consistent with the national laws.

3. Member central banks should ensure that the MoUs can be implemented.

4. There is need for member central banks to enhance the function of supervisory colleges to incorporate routine supervision of cross-border entities as well as crisis resolution through the establishment of Crisis Management Groups.

5. There is need for member central banks to develop a common framework for systemic assessments on the basis of an agreed template, coordinated public communication strategy, and establishment of contingency plans, including stress testing and simulation exercises.

6. It is recommended that member central banks should ensure that appropriate legal framework is put in place to facilitate full implementation of consolidated supervision.

7. There is need for member central banks to ensure continuous investment in capacity building of bank supervisors, particularly in the areas of consolidated supervision, macro-prudential analysis and stress testing, risk management, and financial inclusion.

8. It is recommended that central banks increase the use of joint on-site examinations and prudential information sharing for effective oversight of cross-border establishments.

Financial Inclusion & Financial Stability

9. Central banks/Ministries of Finance should spearhead the development and implementation of national financial inclusion strategy in order to safeguard financial stability in the context of promoting financial inclusion.

10. The financial inclusion strategy should include putting in place frameworks to cover the following:

   - consumer protection framework;

   - financial literacy framework;

- promotion of financial innovation (digital financial services);
- agent banking;
- establishment of credit registries/credit bureaus;
- establishment of collateral registries to formalize the use of movable property in access of credit;
- crowd funding system; and
- supervision of deposit taking microfinance institutions.

Break-out Session III: Institutional & Regulatory Frameworks for Safeguarding Financial Stability in Africa: State of the Art, Advantages and Limitations

Key Observations

Financial Stability: Institutional Framework

1. The meeting agreed that central banks are in a better position to undertake the financial stability responsibility. It was observed that most central banks in the region have established financial stability units which are either standalone departments or divisions within banking supervision department or research department. In executing this function it is essential that the central bank collaborates with other regulatory agencies through a Financial Stability Committee.

Effectiveness of the Existing Frameworks

2. Regarding the effectiveness of the existing frameworks for financial stability, the group observed that the frameworks are effective as they have the following strengths.

   a) Some central banks have been given the legal mandate to ensure financial stability which empowers them to perform this important function.

   b) Central banks have more resources compared to other institutions in the country to address financial stability. These resources include technical skills to monitor vulnerabilities in the financial system, ICT systems and various information required for financial stability analysis.

The meeting however observed the following weaknesses in the current financial stability institutional arrangements:

1. Some central banks do not have an explicit legal power to execute the financial stability function. Most countries are using MOUs to undertake macro-prudential oversight and do not have any legislation backing this function.
2. In some countries the relevant Government ministries are not represented in Financial Stability Committee.
3. Most countries lack quality data for financial stability analysis.

4. There is a shortage of resources such as skilled human resources and, IT in most countries.

5. Majority of central banks lack skills for early warning analysis.

6. In some countries, there is a conflict between macro-prudential policy and other macro-economic policies which include monetary and fiscal policy.

7. Most central banks still lack adequate skills to conduct macro stress testing and quantification of systemic risks.

Recommendations

Based on these observations, the following recommendations were proposed:

1. Clear mandate should be stated in the relevant law, specifying the authorities in charge of the financial stability function.

2. Member countries should intensify training of staff responsible for financial stability. Capacity building should also be provided for supporting functions such as modelling and forecasting. Stakeholder training should be conducted to ensure understanding of key financial stability information such as the financial stability reports.

3. Member countries should strengthen coordination and cooperation between stakeholders of financial stability to improve quality of data.

4. Appropriate early warning indicators for crisis need to be improved for their effectiveness.

5. Member countries should enhance coordination between monetary, fiscal and macro-prudential policies.

6. The central bank should also be given the mandate to conduct Macro-prudential Surveillance using financial soundness indicators (FSIs), early warning indicators, stress testing results, analysis of macro-financial linkages; to develop policies for the mitigation of potential vulnerabilities, crisis preparedness, coordination and strategies for crisis management and resolutions.

Done in Cairo, Egypt, 11 May 2016