Increasing Trade in Banking and Insurance Services in West Africa Monetary Zone

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The West African Monetary Zone (WAMZ) was established in 2000 with the objectives of securing monetary union between the five member states (which comprises The Gambia, Ghana, Guinea, Nigeria and Sierra Leone); establishing a regional central bank; establishing a single financial services supervisor; and, developing a common market for goods and services. The development of monetary union and, also, the willingness of member states to facilitate progress towards a common market in financial services by harmonizing legal and regulatory frameworks, are clearly hampered by the heterogeneous nature of WAMZ. For example, the WAMZ banking market is dominated by Ghana and Nigeria with the combined banking systems of The Gambia, Guinea, and Sierra Leone amounting to only 0.37 percent of WAMZ’s total banking assets, 0.45 percent of WAMZ’s total deposits and short term funding, and 0.29 percent of WAMZ’s total loans.

Some progress has been made towards preparing the basic architecture for financial sector integration in west Africa: first, the west Africa monetary institute (WAMI) was established as the precursor to the west African central bank (WACB) and serves as a secretariat for WAMZ’s governing bodies and an advocate for integration; second, WAMI has prepared common statutes covering banking and non-bank financial sector regulation; third, the statutes for WACB have been adopted; fourth, a framework for a region wide payments system has been prepared; and, lastly, in September 2008, financing was secured (from the African Development Bank) for implementation of potentially interoperable new payments systems in Guinea, Liberia, and Sierra Leone. Nevertheless, WAMZ has made little practical progress towards integration as a result of the unwillingness or inability of its member states both to ratify and pass enabling legislation required to implement WAMZ decisions or to
meet the convergence criteria established as the prerequisite for monetary union.

This policy note identifies a limited number of “quick wins” for integration of the banking and insurance sectors in WAMZ which could be used as confidence building successes from which to build momentum for further integration-centered reforms as well as an agenda for medium-term progress in integration of the sector. The driver for the report’s recommendations is ideas raised by private sector financial institutions in WAMZ.

**Opportunities for Increasing Cross-Border Trade in the Banking Sector**

The transformation of the banking sector within WAMZ is being driven by three main factors: (a) liberalization of cross-border banking activities, primarily in the form of the willingness of member states to permit the establishment of subsidiaries of banks domiciled in other African states; (b) a dramatic increase in the capitalization of Nigerian banks (reinforced by increases in the minimum capital of Ghanaian banks) which has encouraged these banks to seek additional markets within West Africa; and, (c) the growth of pan-African banking groups (such as Ecobank and United Bank of Africa) which have moved quickly to establish subsidiaries in countries across West Africa and the rest of the continent.

Cross-border expansion of banks is driven by the direction of trade - for example, Ghanaian banks planning to expand into Niger (following Ghana’s trans-shipment trade from the coast to the interior) - or by the perception of market opportunities and the need to service corporate clients expanding abroad, as in the case of Nigerian banks expanding into Ghana.

The size differential between the respective banking markets suggests that either: (a) the path to integration of banking systems will have to be driven very much on Nigeria’s terms, albeit mitigated by Nigeria’s desire (strongly expressed in its Financial Sector Strategy 2020) to conform to global standards for banking regulation, supervision, and financial reporting and to comply with Basle core principles. Given that all other WAMZ countries share the same objectives, eventual harmonization around these same principles should be assured; or, (b) a “compromise” where the smaller countries seek to avoid a more or less complete takeover by Nigerian and other multinational banks of their banking systems by harmonizing with each other and maintaining some barriers to entry to protect domestic “champions”. Taking the second of these courses (if it is even possible given that Nigerian and multinational banks are already established in all markets) would deprive the smaller countries – perhaps with the exception of Ghana – of access to Nigeria’s large capital resources, advanced banking technology, and the benefits that the application of scale could bring in terms of system development and increased access to finance.

**Obstacles to Securing the Benefits of Regionalization of the Banking Sector**

The benefits of regionalization of the banking sector come from: (a) greater competition in banking markets leading to the increased availability of banking services and lower prices; (b) increased scale allowing a reduction of risk in the banking sector as a result of the increased ability to diversify both geographically and across sectors and; (c) increased innovation, resulting both from cross-border transfers of technology and increased
competition, and from the availability of the economies scale required to support mass market banking products.

However, there is a number of specific problems which are reducing the benefits of regionalization including: (i) the lack of a functioning official cross-border payments system for WAMZ and no direct link to the UEMOA payments system; (ii) continued wide disparities in the bank regulatory framework between WAMZ countries; and, (iii) a lack of cross-border credit information flow and a corresponding lack of a legal framework for data protection:

**Payments Systems Problems:** The long term solution to the high cost of cross-border payments within WAMZ, and also between WAMZ countries and UEMOA states lies in the creation of a single payments system for WAMZ linked to the UEMOA payments system already in place. The primary cause of delays in building the WAMZ payments system has been an inability to reach agreement on how settlements would be guaranteed in the period before the WACB is formed. Despite ongoing discussions, it seems unlikely that this obstacle can be overcome in the short term. In the absence of an official WAMZ payments system, both traditional and parallel systems continue to operate:

- Payments continue to be routed for settlement via correspondent banks in Western financial capitals.
- For small payments in cross-border trade and between individuals, cash is still extensively utilized.

Increasingly, banks with cross-border operations are operating an internal settlement system. Pending agreement between the WAMZ member states to establish a single payments system, opportunities may exist to develop an interim solution based on the intra-bank net settlement process for cross-border transactions which has been implemented by banks where the counterparties for payments are both customers of the same bank.

Discussions with banks indicated that there is considerable confusion as to whether or not a net settlement system would be possible due to foreign exchange controls, and some banks stated that existing intra-bank net settlements are also prohibited, whereas the banks performing intra-bank net settlements insisted that the settlements are permitted. The completely open operation of cross-border ATM and debit transactions (using Ecobank’s ATM network and VISA) suggests – but not conclusively – that cross-border intra-bank net settlement is allowable. Given this regulatory uncertainty, the banks strongly suggested that this idea be carried forward with participation of the regulators in a pair of pilot countries (Ghana and Nigeria).

Developing a cross-border payments system also requires work to develop uniform regulations and anti-money laundering surveillance mechanisms for cross-border payments through mobile telephone companies. An important feature of this system would be to promote competition between the mobile telephone companies by facilitating mobile payments from one mobile network operator to another.

**Lack of a Harmonized Bank Regulatory Framework:** The absence of uniform accounting standards, regulatory reporting requirements and minimum capital adequacy requirements presents yet another challenge to securing
regionalization of the banking sector. Progress towards the objective of harmonizing accounting standards has been uneven - countries within WAMZ all have the long term intention to harmonize their accounting standards with International Financial Reporting Standards (IFRS).

Bank regulations and supervisory practices are not uniform across the region increasing costs and impeding the supervisor’s ability to assess the risks posed by a subsidiary or parent of a bank which they supervise. A number of initiatives could be undertaken to reduce regulatory costs and prepare for harmonized statutes such as standardization of reporting requirements. A detailed mapping of regulatory reporting requirements could be undertaken to develop a single set of reports required by WAMZ bank regulators and designed to meet the requirements of the model banking statute and compliance with Basle core principles, with additional country specific reports included only to the extent that they are required by current law.

To improve the quality of cross-border bank supervision, two measures are suggested: (a) to standardize the memorandum of understanding (MoU) used to establish information sharing arrangements between supervisors; and, (b) establish a “cross-training” program for supervisors to encourage (and in the case of weaker WAMZ supervisors, subsidize) periods spent working with the supervisors in other WAMZ countries.

**The supply of credit information:** Initiatives are underway in several WAMZ countries to improve the flow of credit information from credit bureaus or central bank administered credit databases (Table 1). However, to date, there has been no legislation permitting the cross-border sharing of credit information in any WAMZ country.

| Table 1: Credit Information Sharing Activities in WAMZ States |
|---------------------------------|-----------------|-----------------|-----------------|-----------------|------------------|
| Activity                        | Gambia          | Ghana           | Guinea          | Nigeria         | Sierra Leone     |
| Credit bureau law               | X               | X               | X               | X†              |                  |
| Private credit bureaus allowed  |                 |                 |                 |                 |                  |
| Central bank credit database exists |                 |                 |                 |                 |                  |
| Private credit bureaus exist    |                 |                 |                 |                 |                  |

This problematic situation is made worse by the absence of uniform data protection laws across WAMZ which would prevent the abuse of customer data stored in regional data centers. These issues suggest that two recommendations need to be implemented in the medium term: (a) WAMZ, preferably working in conjunction with UEMOA under the umbrella of ECOWAS, needs to develop a legal framework for the cross-border movement of customer credit information; and, (b) both WAMZ and UEMOA need to work together to develop a uniform data protection statute which affords equal protections for bank customer information regardless of the location of the data storage or processing facility within WAMZ or UEMOA.

**Opportunities for Increasing Trade in the Insurance Sector**

The insurance markets of the WAMZ countries are not efficient. There are far too many small
insurance companies competing for premiums. Only one company within the entire WAMZ region has a gross premium base in excess of $100 million – Nigeria’s NICON – and NICON is presently under judicial management. With the possible exception of Nigeria, there seems to be a relatively small base of an educated, trained and experienced workforce for the insurance industry and the insurance regulators. The Insurance Institute based in The Gambia caters for middle management and senior staff, as do the education and training courses conducted by West African Insurance Companies Association (WAICA).

The insurance regulators are at various stages of development, with the Ghanaian and Nigerian supervisors best staffed and equipped. Consequently the degree to which the industry is supervised varies significantly across the countries. The region’s regulators share little information amongst each other. There are no formal MoUs whereby information could be shared. Harmonization and improvements in cross border trade could be brought about by implementing certain courses of action, such as a common approach to supervision, licensing and claims payments.

The region’s insurance laws and regulations are diverse. Most of the insurance supervisors seem to be in the process of amending their laws. There are considerable differences in the amount of minimum capital required for obtaining an insurance license in each of the countries, the extremes being in Sierra Leone, where a life license requires $25,000 of capital, and Nigeria, where that same license requires a minimum capital of $13,500,000.

Each of the WAMZ countries has its own set of insurance laws and regulations.

Box 1: African Insurance Forums

*National level: insurance associations and insurance brokers’ associations have been established in each of the WAMZ countries. These appear to be actively supported by the insurance industry as a whole in each country.

*Continental level: there is the African Insurance Association (AIO). The Cameroon - based AIO includes all WAMZ members. The AIO involves its members at a number of levels: annual insurance conferences are held each year in a different country throughout Africa and serves as a discussion forum at the highest level of executives of insurance organizations. Seminars and workshops are held throughout the year to engender discussion on insurance related topics.

*West Africa: There is one insurance treaty signed by all ECOWAS members: the Brown Card Scheme, which provides common third party motor insurance across the region. An anti-money laundering forum has also been established for financial institutions in West Africa.

*WAMZ: The WAMZ area itself has been active in certain areas, and has established some forums specifically catering for this geographic and geopolitical area.

The laws presently do not take risk based capital into consideration – the emphasis is on absolute capital. The relatively high levels of capital requirements in Nigeria impose a significant barrier to entering the insurance market for insurers from other WAMZ countries. Space for regulatory arbitrage in respect of capital requirements is negated by the fact that branch operations are not permitted in any of the WAMZ countries: separate corporate structures need to be established.

Each of the WAMZ countries has an insurance regulator/supervisor. In Ghana, Nigeria and Sierra Leone, separate quasi-independent insurance regulators have been established. In
the case of The Gambia and Guinea, a department within the central bank is responsible for insurance supervision. In Liberia, the insurance regulator is situated within the ministry of transport.

The level of staffing and the quality of the insurance regulatory staff is related to its funding. The insurance regulators within the WAMZ countries recently established a forum although it is not fully operational as yet. A number of regulators do meet informally, and have done so over a period of time. There are no formal arrangements in place between the insurance regulators of the various WAMZ countries, for such purposes as information sharing. The only formal cross border agreement currently in place is the Brown Card Scheme (Box 1). Presently, companies operating in more than one WAMZ country have not yet established functions which are centralized across all countries, such as claims handling or underwriting.

Prerequisites for Increasing Cross Border Trade: Almost all of the insurance products sold in the WAMZ region are in compulsory insurance products, few people purchase insurance products voluntarily, and therefore insurance penetration rates are at world-record low levels. There is very little attention to customer satisfaction. Creating the right conditions for healthy cross border trade, benefitting policyholders and the entire insurance industry could be driven through improved supervision and improved insurance laws and regulations, or improved application of existing laws and regulations.

As WAMZ insurance regulators seem to be either replacing, or considering replacing their laws and/or regulations, there is an opportunity to harmonize insurance laws, regulations and supervisory approaches. Those countries which have not adopted the framework law approach (Guinea, Liberia, Nigeria and Sierra Leone) could consider doing so in the short to medium term. The insurance regulators of all WAMZ countries could improve the environment for growing a viable and healthy long term insurance industry by making a continuous and concerted regional effort to force insurance companies to pay claims in a timely and fair manner, as measured by a continuously increasing percentage of premiums being allocated to the payment of policyholder claims and benefits. Those countries with very low minimum capital requirements (The Gambia, Guinea and Sierra Leone) could also consider adopting Ghana’s approach of requiring a minimum capital of the equivalent of at least USD 1 million for each of their insurance companies/insurance licenses.

Consumer education and understanding also need to be addressed: throughout the WAMZ region, potential policyholders are unaware of the benefits to be derived from owning insurance products. A concerted effort to increase consumer education, drawing attention to the benefit of holding insurance policies, could be carried out throughout the WAMZ region via production and distribution of published material and advertisements.

Conclusions

In spite of the progress realized in both the banking and insurance sectors, WAMZ remains prone to numerous problems associated with banking and insurance sector integration—more specifically these impediments include difficulties to build adequate financial infrastructure such as payment system infrastructure, the lack of harmonization of a legal and regulatory frameworks governing these two sectors, the
lack of credit report bureaus to access financial information of banks and assurance clients, and the high costs of transactions related to the transfer of funds through banks and the insolvency regime.

The urgency is for an immediate solution to accelerate the integration process of these sectors and facilitate trade of goods and services within WAMZ. With regard to the banking sector efforts should focus on: a) reducing the cost of cross-border payments made through the banking system; b) developing a mechanism for small cross-border payments for traders and individuals; c) reducing the cost of bank regulation and supervision; d) improving the quality of cross-border bank supervision; e) improve the flow of credit information. In terms of the insurance sector, focus should be on: a) taking action in order to make the brown card scheme a success; b) increasing the minimum capital requirement in some of the WAMZ countries; c) developing a program whereby insurance companies are forced to play claims fairly; d) harmonizing insurance laws and regulation.

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