THE WORLD BANK
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Promoting Financial Integration in Africa

Lessons from supporting deeper and more efficient financial sectors in East and Southern Africa

IRINA ASTRAKHAN MAY 27, 2014

Financial & Private Sector Development

WHY promote more integrated financial sectors across the region?

- Support cross border trade and real sector activity
- Increase efficiency of transactions
- Deepen investment and capital accumulation

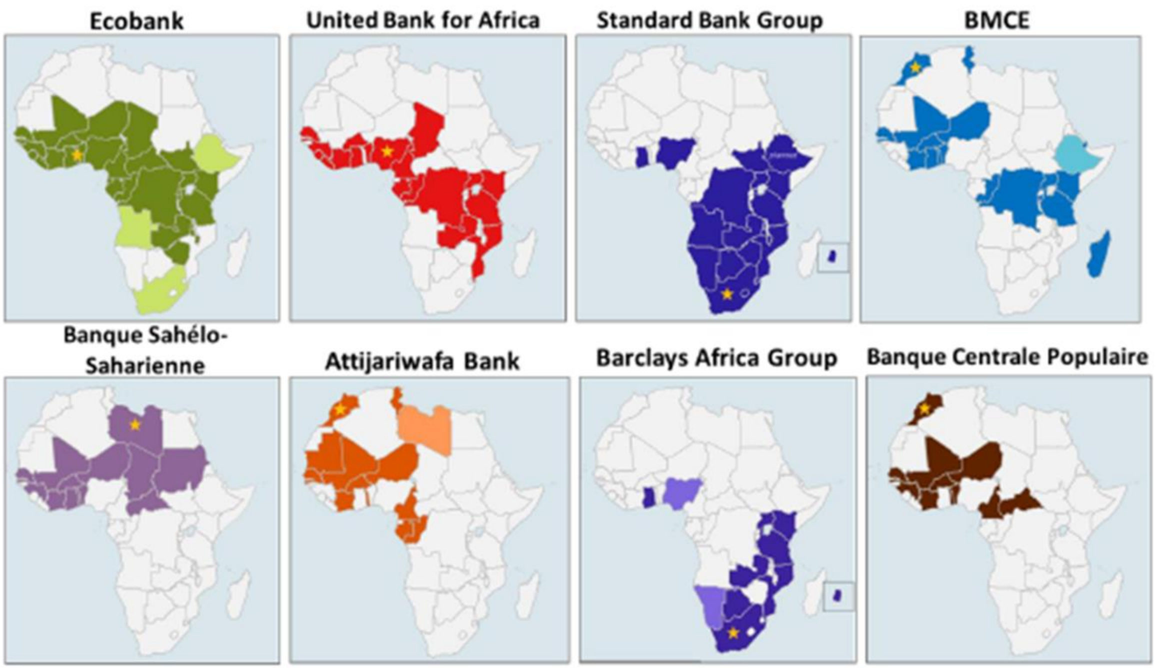
HOW to promote more integrated financial sectors across the region?

- Cross border banking regulation & supervision
- Capital market regionalization
- Trade and supply chain finance
- Financial infrastructure integration
  - East African Community case study

Cross Border Banking 1

- Africa has experienced an unprecedented expansion of African-based banks across the continent in the past decade.
- Primary responsibility for supervising cross-border banks shifted from the traditional home countries in Europe and the United States to African supervisors posing heightened demands on supervisory cooperation between central banks.
- Subsidiaries of African banking groups have become systemically important in a number of host countries.

Geographical Footprint of Major African Banks in Africa, 2013



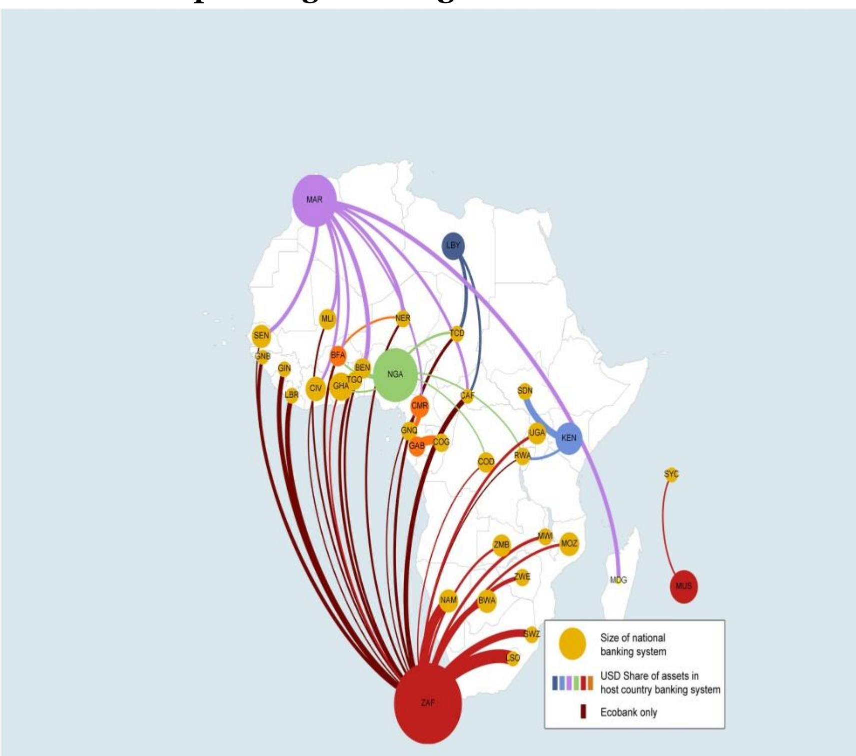
Note: Stars indicate the headquarters of each bank. Countries marked in dark color: presence through branch or subsidiary. Light color: representative office. Source: Annual reports and websites of banks.

Source: Beck et al, 2014

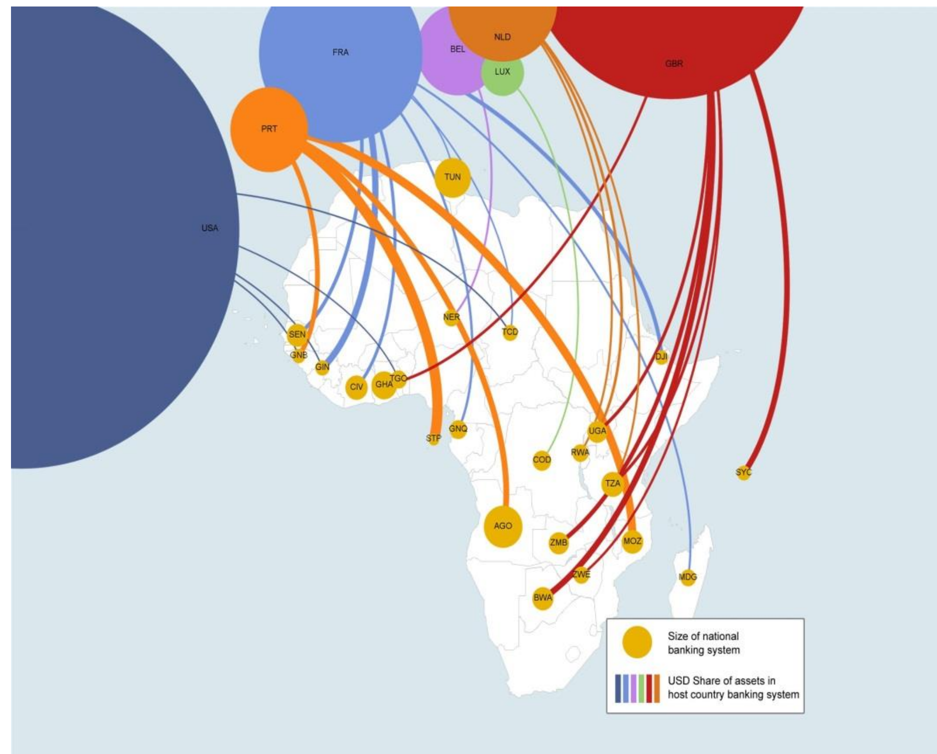
Cross Border Banking 2

- The degree of interdependence of African banking sectors with institutions and markets on the continent as well as globally has become significant.
- The two figures below provide a snapshot of the cross-border ownership linkages from the perspective of host countries.

Ownership Linkages among African Banks



Ownership Linkages of International Banks in Africa



Note: The size of country bubbles reflect the absolute size of the respective sectors. The links between countries reflect the share of host jurisdiction's banking sector dominated by banks in home countries. (Source: Beck, Fuchs, Singer and Witte , 2014)

Cross Border Banking 3

Many African cross-border banks are financial conglomerates with complex group structures . This increases the complexity of conducting effective consolidated supervision.

Two main interrelated questions:

- How can the expansion of cross-border banking across Africa be leveraged to maximize the benefits associated with more integrated regional financial markets?
- Which are the specific cross-border risks emanating from increasingly interconnected and interdependent banking systems in Africa and what do supervisors need to do to effectively safeguard against these risks?

Both benefits and risks tend to rise with growing market integration. Increased openness should be premised on establishing adequate supervisory capacity and collaboration between home and host countries.

Despite progress, most African banking systems continue to be small and costly in terms of overhead, lacking the scale required to significantly reduce the cost of their services. Regional and sub-regional integration is therefore a key condition to achieve economies of scale.

Cross Border Banking 4

Increased efforts need to be undertaken to deepen regional financial integration. E.g. Foreign bank entry can increase competition, bring in skills and innovation and thereby reduce the cost of financial services for consumers.

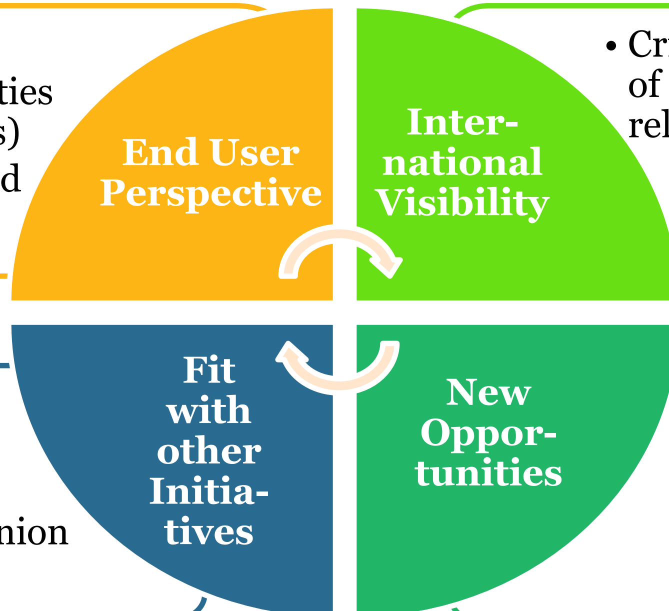
Some suggestions

- **Establish bank-specific supervisory colleges for Africa's largest cross-border banks (e.g.: Kenya).** Given the prevalence of foreign banks across Africa, there is a well-recognized need to strengthen cross-border supervisory practices on a national and regional basis.
- **Upgrade and coordinate resolution frameworks as well as designing credible burden-sharing arrangements.** Supervisors need to work towards binding agreements that will resist the ultimate test of a financial crisis.
- **Invest in the role of pan-African Organizations.** Target those countries and central banks where systemic cross-border risks are imminent or unmitigated. May be a role for pan-African Organizations such as the AACB or the Community of African Banking Supervisors (CABS) in guiding and coordinating this process.
- **Explore advantages and disadvantages of a subsidiary vs. branch model.** Subsidiaries can more easily be ring-fenced to avoid cross-border contagion in times of financial distress. The status quo can lead to inefficient utilization of capital and liquidity, limiting the full exploitation of the benefits of financial integration.

Capital Market Regionalization

Reasons for a regional market

- Larger pool of investors
- Greater investment opportunities (e.g., types of issuers, products)
- Supports Economic growth and job creation



- Critical mass and economies of scale - individual markets relatively small

- Supports common market objectives: free movement of goods, services, people
- Building block for monetary union

More business to

- Intermediaries - banks and brokers
- Market operators (stock exchanges, CSDs)

Main Drivers

- Economies of Scale
- Cost Savings
- Competitiveness

Challenges

- Consensus approach for decision making can slow down process
- Differences in levels of resources, technical capacity, and institutional set-ups between members
- Coordination issues between the regulators and exchanges

Source: Capital Market Regionalization by Evans Osano and Tamuna Loladze, 2013

Trade and Supply Chain Finance

- *Trade finance is a critical link for logistical chains in Africa*
- *Critical to support integration and economic diversification in the region*

- Large African corporates have convenient access to trade finance, which gives them market power. African SMEs lack access, which hampers trade and economic diversification.
- Trade finance facilities in Africa mostly support inter-regional trade, much less intra-regional trade.
- Credit insurance has been a mainstay of regional trade integration in Europe, barely exists in Africa (OECD credit insurance only supports African imports from OECD countries).

Financial Infrastructure Integration
Drivers and Benefits

Drivers

- Political agreements in the context of a broader economic and financial plan for wider trade and to attract investment
- Demands for cost-effective cross-border access to regional and cross-regional markets and services
- Growth orientation and imperatives of existing FIs for expansion into new market areas within or across regions

Potential benefits

- Lower user-costs for individuals, businesses, and public administrations as end-users
- Lower end-to-end transaction costs for the financial firms
- Improved cross-border access and reach to all market participants to financial services, with faster, more reliable, and simpler transaction services
- Lower development costs and operating costs for individual participating members through broader cost-sharing (possibly lower costs even for domestic transactions)
- Improved risk management, greater risk reduction and stronger financial stability resulting from widespread utilization of consistent and up-to-date international policy, legal and technical standards, as well as best-practice risk-management designs and procedures

BARRIERS to Successful Financial Infrastructure Integration

- Insufficient compatibility of the national legal, regulatory and oversight regimes, and/or laws that may impede or otherwise disfavor regional FI integration
- Inadequate harmonization of national FI operating schemes, rules and technical standards, and of the underlying market practices or convention

CHALLENGES to Successful Financial Infrastructure Integration

- Developing a strong business case for the regional FI integration proposal to cope with the natural uncertainties and skepticism about the viability of the project as a whole and for the various individual participants
- Avoiding that immediate cost considerations create a disincentive to participate in the project
- Ensuring there is effective leadership throughout the project life cycle so that the various stakeholder groups cooperate effectively and remain committed to the project
- Ensuring there is sufficient expertise and adequate financial and human resources to develop and implement the regional FI integration program and, once launched, maintain an efficient and safe operation of the new arrangement on an ongoing basis

RISKS to Successful Financial Infrastructure Integration

- Because of the cross-border nature of the regional arrangement, legal, credit and liquidity, operational risks etc. may take on new dimensions that may be more difficult to understand and manage in an effective manner than in a single country arrangement
- Regional FIs can also be more interdependent, and these interdependencies can significantly influence the risks affecting them

Guiding Principals of Financial Infrastructure Integration

Enabling and Institutional Guidelines

- Vision, purpose and scope definition; cooperation & coordination, and buy-in of all stakeholders; ensure effective leadership

Planning Guidelines

- Governance and planning framework definition; comprehensive stocktaking; gap analysis; business case preparation

Design Guidelines

- Definition of a feasible model; outline preparation; definition of cooperative and oversight frameworks

Implementation Guidelines

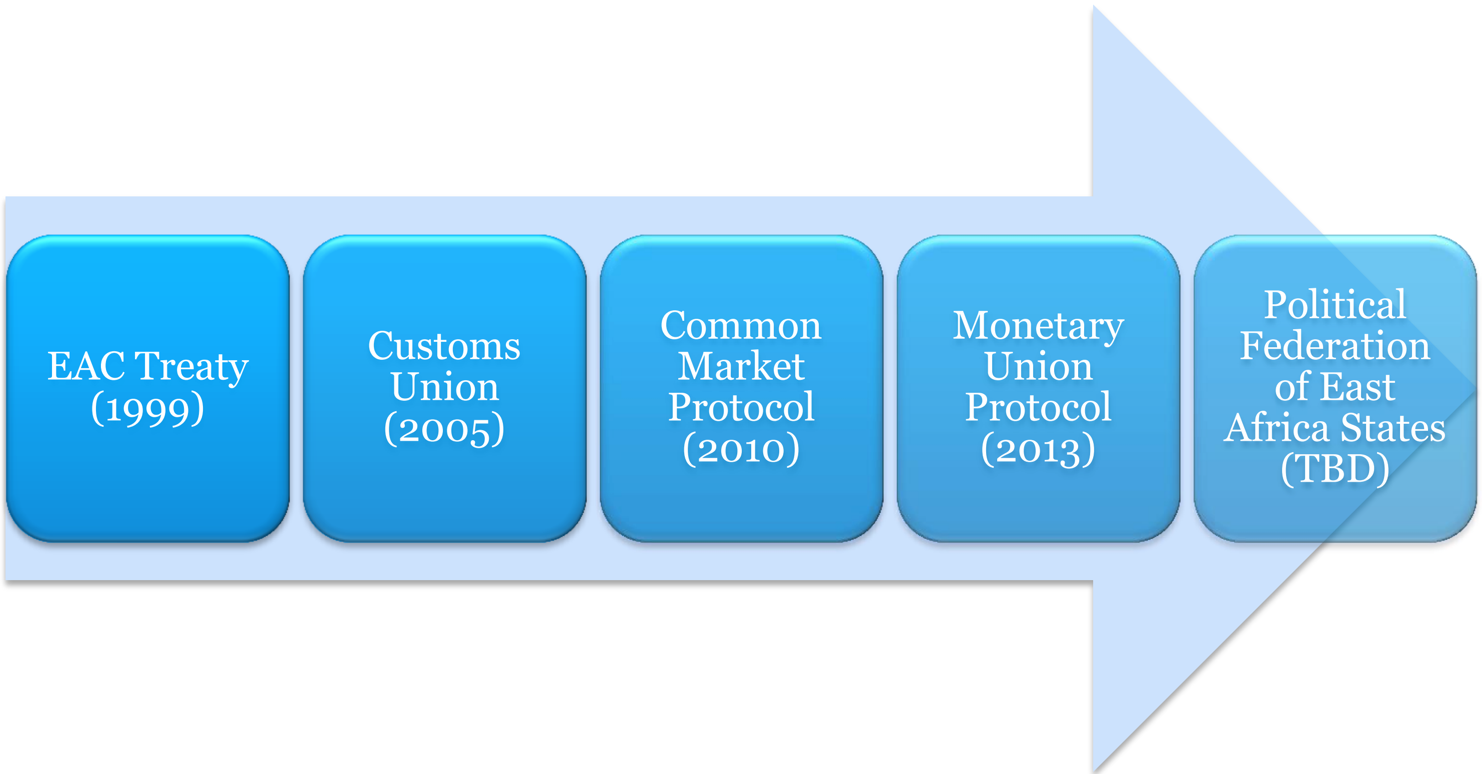
- Establishment and enforcement of proper management; set up of communication function

Sustainability Guidelines

- Regular consultation arrangements; keep management sound and motivated; regular self-assessment and evaluation

Financial Integration: Focus on the East African Community

East African Community Integration Timeline



* *EAC members are Burundi, Kenya, Rwanda, Tanzania, and Uganda.*

EAC Integration – Private Sector Led

- During early 2000s, Kenya's financial institutions led the movement for cross-border banking operations and currently dominate it. There are 10 multinational and Kenyan-owned banks that operate out of Kenya and use it to expand their operations into the rest of the region.
- Kenyan banks have established 251 cross-border branches in the EAC.

Institution	Tanzania	Rwanda	Burundi	Uganda	Kenya
Kenya Commercial Bank	11	13	1	14	171
Diamond Trust Bank	16		4	27	46
Commercial Bank of Africa	8			1	27
Bank of Africa	18			32	28
Fina Bank	-	15		7	15
Equity Bank	6	8		38	148
I&M Bank	6	15		-	22
Imperial Bank	-			3	24
African Banking Corporation	-			2	11
NIC Bank	5			1	23
Totals	**70**	**51**	**5**	**125**	**515**

Data as of December 2012 per national authorities.

EAC Common Market Scorecard

- The *EAC Common Market Scorecard 2014* measures the degree of the EAC Partner States legal compliance with obligations to liberalize cross-border movement of capital, services, and goods.
- It is an assessment of 683 laws and regulations (capital: 124, services: 545, goods: 14), key legal notices, reports, and trade statistics.

Market	Operations/Sectors Covered	Issues Considered
Capital	• Securities Operations • Credit Operations • Direct Investments • Personal Capital Transactions	• Ceilings on value of transactions for non-residents and non-citizens • Discriminatory requirements for approvals for purchase or sale transactions • Prohibition of non-residents to participate in identified classes of investments • Mandatory deposit requirements by Central Banks • Incentives extended only to domestic investors • Discriminatory tax treatment • Restrictions on ownership of firms • Restrictions on transfer of securities • Limitations on amount of credit obtainable from domestic financial institutions • Restrictions to outward investment
Services	• Legal • Accounting • Architecture • Engineering • Retail • Wholesale • Telecommunications • Road Transport	• Nationality requirements • Residency requirements • Licensing and qualifications requirements • Registration requirements • Authorization requirements • Technology transfer/training requirements
Goods	• Tariffs and equivalent measures on intra-regional trade • Non-tariff barriers • Application of the Common External Tariff • Sanitary and phytosanitary standards and technical barriers to trade	• Application of charges of equivalent effect to tariffs • Sanitary and phytosanitary measures • Technical Barriers to Trade • Non-recognition of rules-of-origin certificates • Perforation of the Common External Tariff • Temporary adjustments to the Common External Tariff

Scorecard is part of IFC's EAC Investment Climate Phase 2 project.

EAC Common Market Scorecard

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	• Personal Capital Investments	• Mandatory deposit requirements by central banks
		• Incentive extended only to domestic investors
		• Discriminatory tax treatment
		• Restrictions on ownership of firms
		• Restrictions on transfer of securities
		• Limitations on amount of credit obtainable from domestic financial institutions
		• Restrictions to outward investment.

World Bank Support to EAC on Financial Sector Initiatives

FSDRP I Initiatives	**Securities Legal & Regulatory Framework**	**Capital Markets Infrastructure**	**Pensions**	**Insurance**
Mode	Council Directives	Linked CSDs	New policies	New legal and regulatory framework
Stakeholders	CSD, CMA, Securities Exchanges, CMIPC, SCFEA, Council of Ministers	CSD, CMA, Securities Exchanges, CMIPC, SCFEA, Council of Ministers	Retirement Benefit Authorities/Institutions, CMIPC, SCFEA	Insurance Regulators, Insurance Stockbrokers, CMIPC, SCFEA
Status	• 7 CDs endorsed for transposition • 13 new CDs to be drafted and endorsed in 2014	• IT Infrastructure • New regulations to be drafted and approved	• Recommendation for policy interventions and administrative arrangements	• Assessment of current legal and regulatory framework against ICP

- *CD = Council Directive, CSD = Central Security Depository, CMA = Capital Markets Authority, CMIPC = Capital Markets, Insurance, and Pensions Committee, SCFEA = Sectoral Council on Finance and Economic Affairs.*
- *Each activity above is part of WB's Financial Sector Development and Regionalization Project I (FSDRP I).*

World Bank Support & Lessons

FSDRP I Initiatives	Securities Legal & Regulatory Framework	Capital Markets Infrastructure
Modes	Council Directives	Linked CSDs
Stakeholders	CSD, CMA, Securities Exchanges, CMIPC, SCFEA, Council of Ministers	
Status	• 7 CDs endorsed for transposition • 13 new CDs to be drafted and endorsed in 2014	• IT Infrastructure • New regulations to be drafted and approved

Key Lessons

- Highly consultative process cultivated ownership
- Equal and high-quality representation from each Partner State ensured rich and relevant content in new legal instruments
- Overlap in related working groups membership strengthened coordination and ownership
- Country-level consultations validated rationale for Council Directives
- Flexibility in project implementation

World Bank Support & Lessons

FSDRP I: Securities Legal & Regulatory Framework

- Harmonization of legal and regulatory framework (Council Directives)
- Capacity building among regulators, stock exchanges, and central depository securities

FSDRP I: Capital Markets IT Infrastructure

- Procurement of capital markets IT infrastructure (Smart Order Routing System, Central Depository Interface, and Smart Messaging Platform) and follow on support
- Development of new regulations governing Capital Markets Infrastructure operations
- Capacity building among regulators, stock exchanges, and central depository securities

Key Lessons

- Consensus-building across various levels of stakeholders cultivated ownership from the beginning
- Overlap in related working groups' membership strengthened coordination and ownership
- Equal and high-quality representation from each Partner State ensured rich and relevant content in new legal instruments
- Country-level consultations validated rationale for Council Directives
- Flexibility in project implementation is critical

Thank you.