Restoring Confidence and Building a Resilient Banking System for Ghana

Introduction

The financial system is a critical part of the economy of any nation. For a country such as Ghana, its financial system is very important to the realization of the high aspirations for socio-economic development of its people.

Financial institutions (banks, finance houses, microfinance institutions, and others) mobilize savings from individuals, households, and institutions, and channel them as much-needed capital to those who need them for productive uses in the economy – individuals, households, businesses of all sizes and other organizations.

Banks take deposits from the public by offering a variety of products such as savings accounts, current accounts, and fixed deposit accounts. They also provide services including purchasing Treasury Bills and other investments for their customers. Banks make money primarily by using deposits mobilized from the public to lend to individuals, businesses and other organizations, and government, who need money to meet important economic needs.

The banking system must work for all stakeholders. Depositors expect that funds they entrust to banks are kept and managed responsibly in order that they have access to them in accordance with terms agreed with their bank. Individuals, households, businesses and other organizations rely on a well-functioning financial system to provide adequate funding for their businesses or other economic needs.

Banks, therefore, have a responsibility to ensure that they manage funds prudently, and engage in practices and behaviours that make them safe and sound, so that they are able to attract and retain the trust and confidence of the public. This is important for shareholders, directors, managers, and employees who benefit when banks thrive. It is even more important for savers and other depositors, without whom these institutions will not exist.

Ghana’s financial system is made up of many financial institutions. These include banks, other deposit-taking institutions (such as savings and loans companies, rural and community banks, micro finance institutions), finance houses, and others such as insurance companies, stock brokers and investment fund managers, and pension fund managers and trustees. Of these, banks play a significant role as they hold over 85% of the total assets of the financial system. It is therefore incumbent on banks and their stakeholders to understand their critical role in the Ghanaian financial system and the economy as a whole.

Role of Regulation

All over the world, banks are regulated to help ensure that they remain safe and sound to perform their critical role in the economy. Appropriate regulation ensures that banks operate with the right amounts of high-quality capital contributed by their shareholders, in order to support the risks they assume in accepting and managing deposits, lending, and other banking services they provide to their customers. Simply put, banks must have the financial strength to meet their obligations to their depositors and other customers as and when they fall due. Banks must be governed by a Board of Directors with individual directors who understand the business of banking and possess professional qualifications, practical experience, and moral integrity to discharge their responsibilities to the bank and all its stakeholders. Banks must also have senior managers, managers, and other employees who are qualified, experienced, knowledgeable in matters related to banking, and who possess the moral integrity to handle other people's funds.

Effective regulation helps to promote the safety and soundness of banks, and ensures that banks are able to effectively play their role in supporting the growth and development of the economy. Banks are charged with a special public trust to safeguard customers' savings and wealth, and failure of banks to employ sound risk management practices, effective internal control systems, and good corporate governance, could have adverse ramifications on the entire financial system and the economy as a whole.

In Ghana, the Bank of Ghana (BoG) has the overall supervisory and regulatory authority in all matters relating to deposit-taking and lending business, including banking. BoG's powers are enshrined in the 1992 Constitution of Ghana, the Bank of Ghana Act, 2002 (Act 612) as amended, and the Banks and Specialised Deposit-taking Institutions Act, 2016 (Act 930). BoG is mandated by law to promote the stability of the financial system and to protect the interest of depositors. BoG licenses banks that meet specified requirements for obtaining a banking licence. Additionally, BoG supervises banks on an on-going basis to ensure that they comply with regulatory requirements for conducting baking business. This is a responsibility that the management of the Bank of Ghana takes very seriously.

Key Banking Sector Challenges in Ghana

BoG has recently unearthed a number of weaknesses that existed in the banking sector, some dating back to 2015. Among other things, the sector was plagued with solvency challenges, poor corporate governance practices, weak risk management practices, liquidity challenges, and regulatory breaches.

Solvency: A few banks faced solvency challenges – meaning that they had more liabilities than assets with which to operate their businesses. This posed a significant risk to depositors' funds which were being held by these banks, and indeed, to the financial system as a whole, as banks are part of the wider financial system. The level of capital of most banks was inadequate to maintain their businesses, let alone provide a cushion against any unforeseen problems they could face. The low capital base of many banks also meant that they could not fund many big transactions in the economy without breaching regulatory limits.

Liquidity: Many banks faced persistent liquidity shortfalls as a result of poor risk management, meaning that they were not able to honour their liabilities as they fell due. Some banks, therefore, had become dependent on the Bank of Ghana's liquidity support to survive, which ought not to be the case.

Non-Performing Loans: Many banks were saddled with non-performing loans (NPLs), meaning that they were not able to recover loans they have provided to their customers. This affected the ability of banks to generate income to operate their businesses. It also led to losses which eroded their capital base further.

Corporate Governance: Poor corporate governance and risk management practices led to a number of problems at some banks. Some banks had one or two main shareholders exercising absolute authority and control in the financial and operational management of the bank. Some directors lacked the requisite knowledge and experience to govern these banks, and in many cases failed to appreciate their responsibilities under law to banks and their various stakeholders including depositors. Some failed banks used depositors' funds to finance businesses of their shareholders and affiliates through loans and other facilities with little or no interest earned on such facilities. Many of such facilities were not paid back, and depositors' funds were therefore at risk.

Strengthening Ghana's Banking Sector

In order to address the weaknesses identified above, BoG recently instituted a number of measures to clean up the banking sector and to make it more resilient. Among other things, BoG:

- Closed two banks in August 2017, and appointed PwC as receiver to liquidate both banks;

- Appointed KPMG as official administrator of uniBank in March 2018 to help protect the interest of depositors and avoid the imminent collapse of the bank;

- Increased the minimum capital requirement for banks to GHS400 million, based on an in-depth analysis of the inherent vulnerabilities within the banking system;

- Published the Corporate Governance Directive in April 2018 to promote stronger corporate governance and risk management structures and practices in the industry.

Increase in Minimum Capital Requirement

Historically, the Bank of Ghana (BoG) has revised the minimum capital levels for banks in response to developments in the banking industry and the economy at large. In 2003, the minimum capital requirement was raised from GH¢2.5 million to GH¢7.0 million to enable all banks convert to universal banks. The minimum capital requirement was also increased to GH¢60 million in 2007. In 2013, BoG again raised the minimum capital requirement to GH¢120 million for new entrants and advised existing banks to take steps to increase their capital in line with their risk profiles. BoG issued a Minimum Capital Requirement Directive in September 2017, increasing the minimum capital requirement for all banks to GH¢400 million from GH¢120 million. Banks are required to meet this requirement by December 2018 through the injection of fresh equity capital.

The recent GH¢400 million minimum capital increase was deemed necessary for a number of reasons. In particular:

- **Solvency**: The solvency of most banks was threatened by poor asset quality, leading to significant impairments of capital. Results of an Asset Quality Review (AQR) of the banking industry showed that as of April 2017, some banks had impaired capital leading to capital erosion below the required regulatory levels. Consequently, such banks lacked sufficient capital to support the risks inherent in their asset base, and had no capital buffers to withstand further losses that could arise from external shocks.

- **Macroeconomic impact on capital**: The new capital requirement was necessary to align banks' capital base more closely with macroeconomic realities. High inflation and rapid currency depreciation over the years (cumulative depreciation of the cedi by 51.8 per cent between end-December 2013 and end-April 2018) meant that in dollar terms, the 2007 and 2013 minimum capital requirements of GH¢60 million (US$ 61.8 million at end-December 2007) and GH¢120 million (US$56.4 million at the time) had depreciated in value to $13.6 million and $27.2 million respectively, as at end-April 2018.

- **Credit expansion**: The erosion of banks' capital meant that their ability to expand credit and thereby finance transformative economic projects was constrained. Banks whose business models focus on financing small and medium-sized enterprises (SMEs) also plays a key role in Ghana's economic growth as majority of businesses in Ghana are SMEs. To provide SME financing on a sustainable basis, such banks also require adequate capital with sufficient buffers to ensure that the additional risks they assume can be absorbed by shareholders' funds. A strong and well-capitalized banking sector is therefore imperative to support the transformative agenda of the Ghanaian economy.

- **Good corporate governance**: Stronger banks require effective corporate governance and risk management structures and practices. The implementation of the Basel II and III Capital frameworks requires banks to make significant investments in information technology to support their risk management and governance frameworks. The current paid-up capital of many banks will require significant increase to be able to support such improved structures, systems, and practices.

BoG requires all banks to meet the new minimum capital requirement by December 2018. Bank of Ghana will closely monitor banks' plans to recapitalize to ensure an orderly recapitalization process.

BoG has recently issued its Corporate Governance Directive, which it expects banks to comply with to strengthen their corporate governance practices, thereby promoting investor confidence in them and thereby facilitating access to new capital. BoG strongly encourages banks that may be unable to raise new capital on their own, to explore opportunities to merge with other banks. Such mergers and acquisitions should lead to larger, stronger, and better capitalized banks for shareholders of the merging banks. All proposed merger transactions will have to be vetted for approval by the BoG. BoG is currently in the process of finalizing guidelines on bank mergers and acquisitions to facilitate a smooth consolidation in the industry.

2018 and Beyond: Towards a Resilient Banking Sector Supporting a Vibrant Ghanaian Economy for All

The Bank of Ghana remains committed to promoting a strong, stable, and viable banking industry to support robust macro-economic growth.

While a number of important steps have been taken thus far, a lot remains to be done to promote a more resilient banking industry. Going forward, the Bank of Ghana will continue to strengthen its regulatory and supervisory framework and promote confidence in the financial system.

In addition to ensuring a smooth transition to the new capital requirement by December 2018, the Bank of Ghana will:

- Operationalise the deposit protection scheme established under the Ghana Deposit Protection Act, 2016 (Act 931);
- Address specific risks from high NPLs, poor corporate governance, and poor risk management systems;
- Issue and strictly enforce "fit and proper person" requirements for bank shareholders, directors, and key management personnel, to promote high standards in the industry;

- Promote stronger risk management in banks (including cyber and information security-related risks);

- Implement consolidated supervision powers provided under the Banks and Specialized Deposit-Taking Institutions Act of 2016, to strengthen supervisory oversight over bank holding companies and affiliate companies;

- Continue to roll-out the Basel II/III supervisory framework, and ensure implementation of IFRS 9 by banks;

- Strengthen the capacity and resources of the Banking Supervision Department, improve supervisory processes, and ensure strong enforcement of prudential and conduct regulatory requirements; and

- Improve collaboration with other regulatory bodies to help reduce gaps in the regulatory framework for banking groups.

Conclusion

BoG takes this opportunity to assure the public that it will continue to monitor developments in the banking sector, and where needed, take strong and decisive action at an early juncture to address emerging issues. BoG will ensure that depositors' funds remain safe, and that the financial system remains stable and resilient, contributing significantly to the overall growth and development of the economy.

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