

Caleb M Fundanga: Supervision of non-bank financial institutions

Speech by Dr Caleb M Fundanga, Governor of the Bank of Zambia, at the opening ceremony of a MEFMI/ACBF/IMF - East Afritac Regional Workshop on "Supervision of non-bank financial institutions", Lusaka, 14 February 2005.

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- The Executive Director, MEFMI, Dr. Maruping
- The Executive Director, Africa Capacity Building Foundation
- Representative from the IMF
- Distinguished Workshop Participants
- Ladies and Gentlemen

On behalf of the Macroeconomic and Financial Management Institute for Eastern and Southern Africa (MEFMI), the African Capacity Building Foundation (ACBF) and the East African Technical Assistance Centre (AFRITAC), I wish to welcome you all to this important workshop and to the beautiful city of Lusaka. May I also welcome our distinguished resource persons and thank them for accepting our invitations. I hope their participation will enrich the deliberations of this workshop as well as enhance the knowledge of the participants. Having perused through your programme, I noticed that you have a tight schedule. However, I urge all of you to find time in your busy schedule to visit some interesting places that the city of Lusaka has to offer, including shopping malls, museums, cultural villages, to mention but a few.

Allow me also to thank the Executive Director of MEFMI, Dr. Maruping, for having invited me to officiate at this regional workshop on "Supervision of non-bank financial institutions". I am reliably informed that this workshop is organised by MEFMI, in conjunction with the IMF through the East AFRITAC and the ACBF. The workshop is indeed timely as it is aimed at building sustainable capacity for effective financial sector supervision at a time when our region is beset with a lot of non-bank financial institutions that are financially constrained. I, therefore, wish to commend these organisations for their collaborative efforts and hope that the cooperation exhibited by these institutions through the sponsorship of this workshop will not just end here, but will also grow from strength to strength.

Ladies and Gentlemen

The liberalisation and continued reforms of the financial sectors in our countries has brought interesting challenges to supervisors and regulators, alike. Of particular importance, are the reforms currently taking place in the areas of regulation and supervision of financial institutions. As you are well aware, in a liberalised environment financial institutions play a critical role in the allocation of resources through intermediating between those with surplus resources (depositors) and those in need of resources (investors). In view of the foregoing, effective and efficient supervision is crucial to limit the risk of loss to depositors, henceforth maintaining public confidence in the financial system.

In response to the liberalised environment, there has been a proliferation of linkages between institutions operating in various segments of the financial sector and a growing number of financial mergers and acquisitions, thus creating, in the process, huge financial conglomerates. For instance, banks and insurance companies are searching for growth through the diversification of their activities in such a way that they can no longer be considered as homogeneous institutions falling within the scope of one economic sector and one supervisory system! These conglomerates aim to exploit the synergies that exist among banking, insurance and investment.

This market evolution towards huge financial conglomerates, with integrated product development is slowly blurring the traditional boundaries between banks and non-bank financial institutions, on the one hand, and the supervision of these institutions, on the other. In spite of these trends in the international financial markets, regrettably, supervisory systems, in our sub-region, are mainly structured along the traditional boundaries demarcating banks, insurance companies, investment and micro-finance institutions. These integration changes represent major challenges to the supervisors of the different sectors, especially as the financial institutions become more complex in their structures and operations.

Notwithstanding the foregoing, the sluggish growth of our economies in the sub-region has also created a difficult operating environment for financial institutions, especially banks. As a result, this has contributed to the mushrooming of non-bank financial institutions, such as, micro-finance. It is a fact that the financial sector in our sub-region is dominated by commercial banks, which have continued to service only a small section of the population. The majority of the people are denied access, largely, due to numerous reasons, including perceived risks, high costs involved in dealing in small transactions and the inability to provide marketable collateral for loans.

It is against this background that financial sector supervision should also be directed at financial institutions that pose the greatest risks, such as, non-bank financial institutions. In this regard, the adoption of the risk-based approach allows the supervisor to devote more supervisory effort to those areas that have a high-risk profile.

This therefore, entails that supervisory authorities should shift their focus from the traditional Capital, Assets, Management, Earnings, Liquidity, and interest rate Sensitivity (CAMELS) approach to a more risk-based approach. A risk-based supervisory approach would involve the identification of key risks, the level of these risks and the key risk areas. After identifying these risk factors, a comprehensive supervisory framework with appropriate resources is then assembled to mitigate the risks. The amount of resources required is dependent on the level and intensity of the perceived risk. However, suffice to mention that this does not mean that the risk-based supervisory approach ignores the strengths of the CAMELS approach, but rather addresses the weaknesses by putting more emphasis and resources on areas with potentially higher risk.

Ladies and Gentlemen

As many of us are aware, financial sector operations have become complex nowadays, as they entail, among others, managing financial, market and operational risks, which depend, to a large extent, on public confidence in the financial system. In this regard, proper supervision is critical to minimising risks as well as ensuring the stability of the financial sector and engendering public confidence. This justifies the need for effective regulation and supervision of the operations of banks and non-bank financial institutions compared to other business operations.

Further, with the increase in non-bank financial institutions, their level of risk has also risen. Accordingly, the sheer size of the sector is of systemic importance, hence, effective and efficient regulation and supervision is required to stem any systemic risks.

Ladies and Gentlemen

I am happy to note that this workshop is addressing, in greater details, issues relating to the regulation and supervision of the non-bank financial sector, so as to ensure that the financial sector is safe, secure and efficient.

As I conclude therefore, I wish to urge the workshop participants to participate actively in the deliberations and use this opportunity to tap from the vast experience of the resource persons. I have every reason to believe that this workshop will provide you with the opportunity to share experiences and enhance your knowledge of issues pertaining to regulation and supervision of the non-bank financial sector.

With these remarks, Ladies and Gentlemen, it is now my honour and privilege to declare this regional workshop officially open.

I thank you.