Daniel Mminele: Shaping cross-border banking integration in Africa

Address by Mr Daniel Mminele, Deputy Governor of the South African Reserve Bank, at the Association for African Central Bankers (AACB) Roundtable on "Cross-Border Banking In Africa – A Force for the Good?", Washington DC, 11 April 2014.

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1. Introduction

Good afternoon ladies and gentlemen. Thank you to the conference organisers for inviting me to deliver a few remarks this afternoon on shaping cross-border banking integration in Africa. This is an area which has seen tremendous growth in recent years, particularly with the rise of Africa-based regional lenders.

I will divide my remarks into four parts: I will first reflect on the drivers of cross-border banking within the region; then highlight the benefits of cross-border banking; consider the challenges of integration and finally, consider the role of regulators.

2. Drivers of cross border banking in Africa

Against the backdrop of robust growth on the African continent over the past decade, Africa has become an increasingly sought after and active destination for investment and banking activity. The year-on-year growth in Africa's gross domestic product has consistently surpassed that of the global economy, and that of advanced economies, benefitting from high commodity prices of recent years, as well as rising domestic demand in alignment with trends of increased urbanisation and disposable income within the region[1]. According to the International Monetary Fund April 2014 World Economic Outlook, Sub-Saharan Africa (SSA) is forecast to grow by over 5 per cent in 2014, up from 4.9 per cent in 2013.

SSA saw substantial capital inflows in 2013 totalling US$30 billion[2], with countries such as Ghana, Nigeria and Zambia in particular benefitting from an increase in portfolio inflows, reflecting growing positive global business sentiment towards Africa. There has also been robust loan demand within the region, according to the Institute of International Finance's survey on emerging market bank lending conditions. It would seem then that despite slowing demand for commodities from China, growth could remain supported by improved investor sentiment towards African financing and an increasingly conducive business and debtor environment in the region driving financial deepening and cross-border banking.

Another reason for the rise in cross border banking, particularly in Africa, is the wide-ranging international financial regulatory reform agenda adopted after the global financial crisis. The new and stringent regulatory requirements imposed by jurisdictions such as the US and European Union on their banks have meant that these international banks are doing less business within Africa, opening up an opportunity for larger African based banks to enter new African markets. The integration process is however slow and not without its challenges, as I will elaborate on shortly.

3. Benefits of cross-border banking

Growth in African cross-border banking has not been confined to South Africa's four largest private banks. Banks from Nigeria, Morocco and Kenya, including banks such as Ecobank and the United Bank of Africa, have also taken advantage of emerging opportunities. The

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1 United Nations World Economic Situation and Prospects 2014.

2 IMF Balance of Payments Statistics, February 2014.

resulting increase in the availability of banking services to segments of the African population previously excluded from formal banking, has contributed to enhancing the culture of savings and entrepreneurship with obvious benefits for economic growth and development within the region. With this, Africa has taken significant steps towards having a relatively mature banking system and has increased the resilience of the region to systemic risk[3].

The arrival of regional African banks has improved the efficiency of the banking sector in host countries. They stimulate competition, and increase the diversity of available financial services, generally at transactional lower costs, improved quality and potentially lower interest rates[4]. This in turn positively affects household savings and consumption and the availability of credit to businesses, leading to gains in employment and standards of living.

Furthermore, cross-border integration has the significant benefit of forcing the domestic banking regulatory and supervisory systems to modernize as larger capital flows within a country necessitate improved regulatory frameworks, technological innovation and efficient payment systems[5]. These modernizations also create opportunities for greater financial inclusion, both with regard to individuals and SMEs.

4. Challenges for integration

While cross border banking creates significant benefits, it also is associated with challenges which need to be considered. Unlike the Euro area, where most banks have made relatively similar progress in implementing the Basel III framework, African jurisdictions are still at varying stages of implementing the various Basel capital standards.

First, operating in multiple countries creates supervisory and compliance challenges. The banks are expected to report to both home and host country supervisors who may use different regulatory standards or may interpret similar standards in different ways. In many cases, the same information is reported to different supervisors in different formats as per the relevant supervisor's requirements, which often causes duplicate reporting or banking entities operating in different jurisdictions may have to provide reporting on potentially all three Basel standards. These differences become even more pronounced when considering the operational and business impact. Although African regulators have been notably increasing their level of training and understanding of all Basel frameworks, it remains necessary for banking groups to appoint staff members with different skills to address the various elements between the Basel frameworks, and to implement systems that have the capacity to cater for all the different regulatory and reporting requirements. This can be both time consuming and resource intensive for a bank.

Second, the differences in the roles and responsibilities of home- and host-country supervisors can create challenges. More specifically, a home-country supervisor is responsible for the solvency of the banking group, while the host-country supervisor's role is to ensure that there is sufficient liquidity to meet all obligations and to protect depositors in its jurisdiction. Such differences can lead to both overlaps and gaps in the regulatory framework applicable to a bank, thereby creating problems of regulatory coordination. One way to address these challenges is through the establishment of cross-border supervisory and crisis management groups for systemically important banks in Africa. I will elaborate further on this topic later in my remarks.

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3 Oxford Policy management. 2013. "Cross border banking supervision in SADC region".

4 BIS Papers No 76.

5 Levine, R (1996): "Foreign banks, financial development and economic growth", in C Barfield (ed), *International financial Markets: harmonization versus competition*, Washington DC, AEI Press.

Third, these banks can become means for transmitting risks from one jurisdiction to another and thus can reduce the authorities control over their economies. This can cause authorities to introduce protective regulations that complicate cross border banking.

These challenges raise the obvious question of what can be done to minimize the negative aspects of cross border banking and maximize their benefits. Clearly, the governing bodies of relevant regional economies need to agree to co-operate in creating the regulatory and policy frameworks for managing cross border banking and ensuring effective financial integration. These arrangements should then address issues of common concern to various banking groups and also provide a platform from which to discuss issues that the supervisory authority believes are hindering financial integration in the region. Examples of such issues of common concern, in addition to what has already been raised, include issues such as localisation (where banking groups are of the opinion that they require at least 75% of the voting rights and therefore shareholding, in order to effect a special resolution decision) and capital protection (where banking groups may also be concerned about future restrictions on the movement of capital within the group, including the impact of currency fluctuations).

In light of the challenges I just mentioned, the cross-border integration in Africa of internationally accepted banking supervision standards, improvement of financial sector disclosure and governance practices is therefore crucial not only to ensure the appropriate and effective supervision of banking groups that are significant in an African context, but also to limit the regulatory burden and associated cost burden on banks and consumers of financial products.

However, it is important to recognise that these challenges also create opportunities to promote regional financial integration. South Africa is therefore fully supportive and active on committees such as the Association of African Central Banks, SADC Committee for Central Bank Governors (CCBG), the FSB's Regional Consultative Group for sub-Saharan Africa and the Community of African Banking Supervisors (CABS). The work of these important committees all contribute towards the development and implementation of an effective financial sector regulatory framework in Africa.

Promoting cross-border banking in Africa and implementing regulatory co-ordination measures to address these concerns could have substantial benefits in promoting growth in the continent.

5. Role of regulators and international and regional forums

Regulators have a particular role to play in the integration process as the success of financially integrated markets starts with the regulatory authorities ensuring that the entities allowed into their financial sector meet all the relevant requirements for access to the relevant jurisdiction. For this reason, it is important to conduct rigorous assessments to accurately determine the costs and benefits which arise from allowing a foreign bank into a jurisdiction.

In order to ensure the African banking sector remains adequately integrated, with minimal negative spillover effects felt from cross-border banking in both the home and host country, regulators need to be appropriately equipped to deal with cross border banks. This requires:

- Staying abreast of the latest international regulatory developments: Those of us who participate in regional and international financial standard-setting bodies have an obligation to play a pro-active role, to use our strengthened voice, be ready to take constructive positions on the various reforms and consider the views of those countries that are not at the table. This highlights the importance of the Financial Stability Board (FSB) regional outreach groups and the CABS.
- Encourage progress in the implementation of the Basel Capital Accords, so as to create a level playing field, which makes it easier and more cost efficient to start-up a business in a new jurisdiction. However, implementation of international standards

must be done taking into account country specific circumstances and should not be at all costs, or to the detriment of the stability of the financial system.

- Maintain the emphasis on information exchange: There is already a pronounced effort to make existing mechanisms of information exchange more meaningful, such as Memoranda of Understandings (MoU) between home and host countries. This was a principal aim of the SADC Subcommittee of Banking Supervisors (SSBS) initiated in 2006[6]. Unfortunately, due to differences in accounting standards, reporting requirements, off-site monitoring systems, regulatory frameworks and supervisory practices, drafting and implementing effective MOU's is difficult and they are not always used for their intended purpose.
- Efforts should be made to create databases that are useful and available to all African regulators and regional workshops should be encouraged (such as the Enhanced Data Dissemination for Africa regional workshop held in 2011). Such initiatives contribute to skills development and information sharing, and create opportunities to develop new connections between regulators and new means for coordinating and standardizing the methods for compiling, processing and disseminating data.
- Supervisory colleges have proven to be highly useful in ensuring information sharing and relationship building between supervisors and are therefore valuable tools to promote. Effective consolidated supervision of an international banking group requires the home supervisor to have sufficient knowledge of the operations of the group, both domestic and foreign, so as to monitor, assess and deal with risks faced by the group. As noted by past Roundtable discussions on regional banks in Africa, Regional Economic Communities (REC), in which most Pan-African financial banking groups operate, can be very useful in this regard due to their specific focus on building supervisory capacity and strengthening cross-border regulations[7].
- Ensure that existing crisis management and resolution plans are enhanced and put in place to withstand financial crises: Prompt and effective responses to potential financial distress are important to avoid severe systemic disruptions and minimise the risk of banking failures. If not properly managed, supervisory co-operation might collapse when a financial crisis hits as protection of national assets will become very important. Establishing upfront crisis management and resolution plans will facilitate robust supervisory co-operation which should withstand the pressure of a cross-border financial crisis.

6. Conclusion

In conclusion, financial integration in Africa has already had a positive effect on the growth potential of the continent. It is, however, vitally important that the integration process continues to be monitored by the regulatory authorities to ensure its success and sustainability. Without an integrated regulatory authority environment, achieving a robust integrated financial system would be difficult.

It is therefore important that we as regulators use all the tools at our disposal, implement new and innovative ways to communicate, share information and ensure that we develop apace with the market and its needs, because without doing so we cannot create and sustain an effective cross-border financial integration.

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6 South African Reserve Bank. Bank Supervision Department Annual Report 2012.

7 Association of African Central Banks. 2012. Roundtable on Regional Banks in Africa: "Safeguarding and Leveraging a New Force for Financial Sector Development in Africa".

I look forward to further informative discussions on the topic, such that we all may learn from past mistakes, successes and achievements whilst also continuously striving to address the challenges in unison with one another.

Thank you.