

A CRITICAL LOOK AT BANKING SECTOR REGULATIONS IN CAMEROON

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Abstract: The Cameroonian banking sector has failed to make the required contribution to the economy, this paper seek to enquire whether such state of affairs is cause by ill-conceived regulations or whether the problem is at the implementation phase. Before doing this the paper took an eagle-eye view of the banking sector in the country. Findings reveal loopholes at both the designed and implementation phases of regulations. The paper concluded by making such recommendations at either stage in the regulatory process.

Keywords: Banking, regulation, supervision, economic growth.

1 Introduction

As we very much know, the financial sector is the most heavily regulated sector of the economy, and banks are among the most heavily regulated of financial institutions. The reason for this is obvious; the financial sector is often regarded as the “engine of growth” in any economy. Without the financial sector mobilizing financial resources from net savers and ensuring their allocation and relocation to the most productive uses. They achieve this allocation and relocation functions by collecting information to handle the information asymmetry and moral hazard problems which often make the provision of financial services difficult. By making it possible for financial resources to be provided to their most productive use, the financial sector enables economic growth in an economy together with all the benefits that come with such growth.

The above mentioned role played by the financial sector partially explains why the sector is heavily regulated and why most countries go to great length to ensure that there are up-to-date legislation to make sure that this sector does plays its intended role. Secondly, the number of financial crisis that have occurred over the past three decade worldwide, latest of which is the 2008/9 subprime crisis and the huge cost involve in bailing these institution each time such a crisis occur, can also explain why this sector is heavily regulated.

In Cameroon, the banking sector has been blamed for making very little contribution to the growth of the economy, (IMF, 2009). The rate of penetration of banking services have been low, while banks have excess liquidity, they rely mainly on short-term deposits, (ADfB, 2009),and cover only a few high net worth individuals and corporate who are considered less risky while the greater part of the population and SMMEs are left without any form of financial services.

Looking at the above statements one could say that in Cameroon, the financial sector has failed to perform its “engine of growth” function. Assuming that the financial/banking sector is heavily regulated to ensure that it plays the above mentioned role, the question that comes to mind is: are banks in Cameroon well regulated if one compares them with what is taking place in other countries? Or is it a case of ill-conceived legislation or the execution of such legislations by the regulatory/supervisory authorities? This paper seeks to find answers to these questions and many more, but before we answer them let look briefly at the banking sector in Cameroon.

2 The Banking sector in Cameroon.

2.1 Overview

The last state-owned bank in Cameroon was sold in January 2000, this was the last step in a Structural Adjustment Programme (SAP) recommended by the Bretton Wood Institutions for the country to reach the completion of the Highly Indebted Poor Countries’ Initiative (HIPC). This initiative was recommended to re-launch the country’s economy after a decade of economic crisis that seriously affected its banks. This crisis led to the liquidation of giants such as Cameroon Bank, Banque Meridien, Rural Development Fund-the development bank, the split-winding of the Bank of Credit and Commerce of Cameroon (BCCC), with transfers of its good assets to Standard Chartered Bank of Cameroon.

The failure of these institutions was followed by a raising of the initial capital requirement of commercial banks from CFAF¹ 300million to CFAF 1 billion, (Kouassi, Akpapuna & Soededje, 2007). This operation sped up the logic of consolidation in the early 1990s, however the sharp devaluation of the CFA Francs in 1994 accelerated the reserve of French banks towards a Cameroonian economy struggling to emerge from a strict regime of the IMF, (Common Wealth, 2009).

Since this period the banking sector in the country has struggle to offer any substantive contribution to the growth of the economy, however the last five years or so have offer some hope with the entry of more players in the sector bringing the number of commercial banks to 13, with more still expected. The players include the following;

- Société Générale des Banque au Cameroun (SGBC).
- SCB- Credit Lyonnais du Cameroun (SCB-CL).
- Amity Bank Cameroon Plc*.
- Ecobank
- Afriland First Bank*.
- Commercial Bank of Cameroon (CBC)*.
- Union Bank of Cameroon (UBC)*.

¹ The CFA Francs is the currently use in Cameroon and the other 5 countries with which it share the monetary community. CFAF 460= \$1 is a fair conversion.

*Indicate banks with majority Cameroonian ownership (this exclude government ownership).

- Citibank
- Banque Intenationale du Cameroun pour L'Epargne et du Credit (BICEC).
- Standard Chartered Bank of Cameroon (SCBC).
- Oceanic Bank
- United Bank for Africa (UBA).
- National Financial Credit Bank (NFCB)*.

Banks in Cameroon, both domestic- and foreign owned have been found to offer loans only to a few high net worth individuals and corporate, with a narrow range of product offering. This state of affairs has leaved most Cameroonians without any contact with the financial world. Even though one can point fingers to banks for not offering credit to ordinary Cameroonians despite having excess liquidity on their balance sheet, the high number of non performing loans and difficulties in recovering loans through the courts are major difficulties faced by banks in this country. Cameroon's financial system is not fully developed, and the absence of a vibrant credit market has been found to hinder more dynamic economic growth. Most analysts see growth opportunities in offering financial services to the 'unbanked' and tapping the potential of the vast informal sector, which comprises approximately 45% of the economy, (Common Wealth, 2009).

2.2 Ownership of Banks in Cameroon

In 2007, ownership of banks in Cameroon was as follows; Cameroon government 9.8%, Cameroon nationals 33.3% and foreign nationals 56.9%. The recent entry of banks such as Oceanic Bank and the buying of majority stake by a Moroccan banking group in SCB-CL and Atlantic bank in Amity bank have tilted things in the favour of foreign nationals. This state of affairs could be blamed on the Douala Stock Exchange which since inaugurated in 2003 has failed to mobilize funds from the Cameroonian public to the favour of foreign investors with huge capital to buy big stakes into the country's banks.

Whether this ownership pattern is healthy for the country or not is an argument for another paper, what is clear however is that the country's economy is squarely being placed at the mercy of foreigners whose prime interest is to repatriate as much profit out of the country as they can. This also exposes that country to external shocks, as investors may at any time move their funds to correct imbalances in their domestic economies. This notwithstanding, the foreign-owned banks have been found to add stability to the local banking sector by being better capitalized and more regulatory compliant than their domestic-owned counterparts who are more vulnerable to credit risk and less regulatory compliant. Their profitability and solvency are under pressure due to decreasing interest margins, (IMF, 2009).

3 Banking Sector Regulations in Cameroon

3.1 Overview

Regulation and supervisory functions of banks in most countries are carried out by central/reserve banks, in Cameroon that is not the case. Cameroon and five other central African states i.e. Chad, Central African Republic, Equatorial Guinea and Gabon share a common central bank, the Bank of central African state (BEAC). BEAC is the central bank of the six states under the umbrella of the Central Africa Economic and Monetary Community (CEMAC). BEAC however does not carry out regulatory/supervisory function but created a separate commission called the Central Africa Banking Commission (COBAC) to take care of the administration, regulatory, supervision and sanctioning over of banks that sought license with the central bank, (Kouassi et al 2007).

According to a World Bank report, the close relationship between the central bank and COBAC (the regulatory agency) makes for a weakened enforcement capacity. The governor of BEAC presides over the board of COBAC as well as the vice governor of BEAC, which leaves the organization partially independent from BEAC, (IMF, 2009). This disconnection between the central bank who are the custodian of monetary/fiscal policy and the regulator/supervisor of banks, can only cause problems in execution of these policies.

3.2 Regulation Instructions in Cameroon.

The banking industry in Cameroon is governed by a series of enactments (conventions, laws, ordinance, presidential decrees, ministerial orders and circulars). These enactments are frequently amended and annulled due to contradictions and difficulties in their interpretation and implementation. In this regard, it's clear that banking regulation in Cameroon emanates from both within and without the country. They emanate from both the local ministry of finance and COBAC (whose supervisory mandate covers the other 5 CEMAC countries). BEAC is the sole central bank for the six countries and have operational branches in each of the six member countries while COBAC supervisory powers also cover the six member countries. In the section that follows, we criticize specific aspects in banking regulations in Cameroon.

3.2.1 Regulation on Capital Adequacy

Most banks in Cameroon especially the locally-owned banks are considered as being heavily undercapitalized, (IMF, 2009), as they have a capital adequacy ratio of less than 8%. Even though the minimum capital was recently increased from \$2000000 to \$4000000; observers still consider Cameroonian banks as being undercapitalized as most have a leverage ratio below 5% (Djiné, 2011).

The importance of capital to the soundness of any banks cannot be overemphasize here, capital (especially equity) help fight moral hazard by ensuring that banks have much to loss when they involve themselves in any risky behaviours. Capital also functions as a cushion when bad shocks

do occur, making it less likely that the financial institutions will fail, thereby directly adding to the safety and soundness of financial institutions, (Mishkin, 2010). Without comprehensive legislation to handle the undercapitalized nature of these banks, the regulatory authorities will be overwhelmed by many banks which will be seeking financial assistance and exhaust their “lender of last resort” funds. To avoid this situation, the regulatory authorities should undertake extensive research to determine the appropriate capital level that will place banks in the country in a save capital position and set the scene for them to make their rightful contribution to the country’s economy.

In stipulating capital requirement for banks, regulatory authorities in Cameroon must also take into consideration the risk-based capital requirement as stated in the Basel Committee on supervision, which ties capital to the risk level of banks. Considering the limitations of the Basel 1 Accord, regulators must ensure that they follow the never-ending work of the Basel committee on bank capital requirement.

3.2.2 Regulation on Incorporation

According to the 1985 ordinance, there is no restriction on ownership; hence it’s possible for the existence of 100% privately-owned banks and offshore offices of foreign banks. The ordinance of November 1990 ushered in a new investment code, that gave equal rights before the law of both local and foreign investors (both individuals and corporate). According to later ordinances, commercial banks are only types of banks allowed in the country, these banks are expected to operate as public limited liability companies (even though their shares are not yet publicly traded).

The recent high appetite for the Cameroon banking market from foreign investor as earlier mentioned goes a long way to strengthen the country banking sector, but the operations of the Douala Stock Exchange should be sped up to list banks and make it possible for local investors to invest in local banks. Regulations should also be put in place to limit foreign ownership of the country’s banks. These measures will serve as a prudential action to prevent the country against external shocks which may occur if these foreign investors suddenly move their funds to correct imbalances in their home economies.

3.2.3 Regulation on Prompt Corrective Action, Chartering and Examination

COBAC, the regulatory and supervisory arm of the regional central bank carry out prompt corrective actions to ensure that banks in the country and sub region are adhering to instructions laid down by them while the local ministry of finance does the same. This arrangement however hampers both bodies from fully carrying out such duties, firstly COBAC is reported to have limited resources (especially human), and considering the large geographical area that they cover, this adversely affect the number of times they may take prompt actions to correct an abnormally in the system. Secondly having two regulators may create problems with the demarcation of jurisdictions, this may lead to a situation where certain areas may be neglected or

even the possibility of duplicating roles. Considering the importance of prompt corrective action which in most cases serves to restore sanity and confidence in order to avoid runs on the banking system, an action that requires regulators to take quick actions, having two regulators only goes to delay such prompt actions.

Overseeing who operates financial institutions and how they are operated, referred to as financial or prudential supervision is an important method of reducing adverse selection and moral hazard in the financial sector, (Mishkin,2010). Through chartering, proposals for new institutions are screened to prevent unwanted people from controlling financial institutions. Again the dual-regulators only goes to delay the issuing of such license as both finance ministry and COBAC must both give their approval before a license is issued.

The same applies with the examination role, who should examine banks? COBAC or the ministry of finance? Even though attempts have been made to demarcate duties between the two regulators, there are still times when such question arises. With COBAC's staff challenges while having a wide area to cover, the CAMELS rating may not be undertaken. The acronym is based on the six areas assessed: Capital adequacy, Asset quality, Management earnings, Liquidity, and Sensitivity to market risk, (Mishkin, 2010). Without getting such information about a bank's activities, it would be difficult for regulators to correctly assess the health of banks talk less of enforcing laid down regulations.

Banks however submit regular reports to both COBAC and the ministry of finance, such report are intended to reveal banks' assets, liabilities, income, dividend, ownership, foreign exchange and other details. Both regulators also make unannounced visits to banks, but as earlier mentioned inadequate staffs at COBAC are hampering such visits.

3.2.4 Regulation on assessment of risk management

Managing risk is a very important part of the management of any institution, most especially banks. Innovations in the financial industry has produced new markets and instruments and make it very easy for banks and their employees to make huge bets easily and quickly, this make the absence of a comprehensive risk management regulation very worrying. Examination that focuses only on a financial institution's position at a point in time may not be effective in indicating whether they are in fact taking on excessive risk. This also fails to assess the soundness of banks management processes with regards to risk management.

The absence of risk management assessment tools by the supervisory/regulatory authorities in Cameroon means that risk management rating systems such as does use as part of the CAMELS protocol use by the US Federal Reserve and the Comptroller of currency in the US are not existent. The four element in sound risk management under this system ratings from 1-5 on (1) the quality of oversight provided by the board of directors and senior management (2) the adequacy of policies and limit for all activities that present significant risk, (3) the quality of risk measurement and monitoring systems, and (4) the adequacy of internal controls to prevent fraud

or unauthorized activities on the part of employees, (Mishkin, 2010). These ratings have the potential of exposing risk management flaws by banks, which will serve as early warning signs for regulatory authorities and hence make their work easier.

Other areas of regulatory risk management intervention should include; banks' management of interest rate risk, operational risk, credit risk, market risk and the huge liquidity risk that the country's banks face. Monitoring could also be done to track the implementation of tools such as stress testing, which calculate losses under dire scenarios, or value-at-risk (VaR) calculations, which measures the size of the loss on a trading portfolio that might happen 1% of the time-say over a one month period. Even though one could argue that since the banking sector in Cameroon is underdeveloped and does not have such sophisticated products found in other market, which make it easy for banker to take quick bets, this does not excuse the absence of a comprehensive risk management regulation.

3.2.5 Regulation on consumer protection

Apart from the fact bank charges and other charges such as charges on foreign exchange transactions are regulated by the ministry of finance, there is no broad consumer protection regulations that to protect consumers from unfair treatment of any kind. As the recent subprime crises illustrated to us, millions of borrowers took out loans with terms that they not understand and which were well beyond their means to pay. The crises have proved to us that consumer protection is much more than charging exorbitant rates, it involve information disclosure and much more. Legislations such as the National Credit Act in South Africa that was put into law a couple of years ago is a good example to emulate.

3.2.6 Regulation on restriction to competition

As far as this researcher knows, there is no specific act from both regulatory authorities that talks about restricting competition. In fact the continuous increase in the number of banks in the country indicates that regulatory authorities are encouraging competition amongst banks. However to cope with this increase competition, banks are induced to leave their traditional activities to engage in the conquest of market share in unknown and difficult to evaluate market, indicating high risk. In this regard anticompetitive regulations will be relevant in order not to push banks into too much risk taking behaviours. Care should be taken in doing so in order not to stifle innovation in the financial system which may instead lead to higher charges to consumers and decrease efficiency in the banking sector.

The feeling that the presence of foreign banks will promote competition as local banks learn from them is sometimes just an illusion. As has been found in Cameroon, some of the foreign banks in no time start doing things like the local counterpart. There should be no regulatory bias in either type of bank or the regulatory authorities must collaborate with their home regulators in order to properly regulate these foreign banks.

3.2.7 Regulations on lending limit and government safety net

According to legislations, banks' lending to one borrower must not exceed 45% of its funds and total loans to borrowers representing over 15% of capital fund, must not in aggregate exceed the total of net capital. The high figures in a nutshell simply reiterate the fact that credit lines in the country are only available to a few high net worth individual and still represent high risk positions for banks.

As earlier alluded to, there is no deposit insurance in Cameroon. The absence of deposit insurance is in line with research carried out by the world bank, which found out that, on average, the adoption of explicit deposit insurance was associated with less banking stability and high incidence of banking sector stability,(World Bank,2001).They also found out the deposit insurance retarded financial sector development. However the negative effect of such scheme were found to appear in economies with weak institutional environments: the absence of the rule of law, ineffective regulation and supervision of financial sector and high corruption, (World Bank, 2001). With Cameroon's economy mirroring most if not all of the above stated qualities, the absence of a deposit insurance scheme is sensible decision to take.

In the absence deposit insurance, the only other government safety net has been the central bank playing the famous lender of last resort role. However, the experience of Cameroonian with previous banking crises has shows that the central take a very long time to execute this duty and sometime intervene when it's too late. Intensifying early warning signals will be a step in the right direction.

3.2.8 Regulation on asset holding

Bank regulations that restrict asset holdings are directed at minimizing moral hazard behaviours by banks that can cost taxpayers dearly in bailing them out. Even in the absence of government safety nets, as in the case in Cameroon, financial institutions still have the incentive to take on too much risk. Risky assets may provide financial institutions with higher when they payoff; but if they do not pay off and the institution fails and depositors are the ones to loss. Because depositors are unable to get information on the operations of banks in order to punish them when they are taking excessive risk, the government through its regulators remains the only way by which to impose market discipline by restricting the holding of certain high risk assets such as common stocks. The regulator should in the same vein also promote diversification and reduce risk by CFA loan amount to particular sectors or individual borrowers.

4 Conclusions

The paper set forth to criticize banking regulations in Cameroon, before doing that it briefly took an overview of the banking sector in the country. The paper found out that the banking sector was highly concentrated i.e. offered a narrow range of products to a very small percentage of the population. Apart from these attributes, the banks were also found to be highly undercapitalized

especially the local-owned ones. foreigners were found to own more than half of the banking sector and counting, even though their ownership was found to expose the country to external shocks as a result of sudden movements in funds, they are providing stability to the country's banking system by being better capitalized and more regulatory compliant than their locally-owned counterparts. The poor functionality of the Douala Stock Exchange was also promoting this state of affairs by not making it possible for Cameroonians to buy stakes in the banking sector.

On the regulation/supervisory front, the greatest problem was the presence of two regulatory authorities, one which is the local ministry of finance and the regional regulator, COBAC. COBAC has been assigned nearly the full range of powers that national prudential supervisory authorities have in other countries. It is in charge of off-site and on-site supervision and issues prudential regulation. It shares responsibility with the national ministries of finance for the licensing of new banks, and it has the authority to sanction credit institutions, to revoke banking licenses and to decide on liquidation of banks.

Nevertheless, the division of responsibilities between a supranational institution and national authorities can lead to frictions. Although a clear legal hierarchy has been established under which supranational provisions override the national legal framework, in practice COBAC has to rely on the respective national authorities' willingness to cooperate for the implementation and enforcement of its decisions. This double authority creates problems of administration as can be seen in the case of Licensing. Even though the 1992 Convention gives joint responsibility for issuing banking licenses between the national authorities and COBAC, with the latter having prime responsibility. COBAC's consent is needed for every licensing act for banks and bank directors. This two-level licensing process can only cause unnecessary delays, concomitant judicial validity and enforceability problems for management decisions taken while a licensing decision remains pending.

Away from the two-regulator arrangement, a number of prudential roles (including capital requirement, risk concentration and internal control, etc), are less stringent than international standards. According to Koussi et al 2005, these roles were established several years ago when the banks in the region were facing sizeable problems. However COBAC has expressed its intention to meet up with international standards on these issues.

Considering the high operational risks that banks in the country face in the current fragile legal and judicial environment, capital requirements should be higher than in other countries with reliable legal systems. The risk profile of individual banks will also have to be considered for this to exercise to be carried out successfully. Finally, capital requirement should take into consideration the substantial macroeconomic risk facing the Cameroon economy into account. As a first step, the minimum solvency ratio should be raised to the international level of 8 percent, (Kouassi et al 2005). In legislating on capital requirement, caution should be exercised as it has been demonstrated that the effect of strengthening the capital on the fragile banking sector may be contrary to that expected if it leads to portfolio reallocations in favour of riskier assets, (Djiné, 2011). In the light of the current situation of limited professional training and

expertise in the sector, internal control regulations should be reviewed, likewise regulation of connected lending which many observers considered as being too lenient.

In addition to the above, improving court procedures are of utmost importance. In a country like Cameroon where corruption has infected the courts, judges also struggle with commercial issues of the law. Without training these judges or creating specialized commercial courts, these inefficiencies delinquent borrowers (that could, but will not pay) hide can be dismantled. This will require legislation and much more to do.

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