Study on Scan of SADC Development Finance Institutions' Environment

CEOs' Forum

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Background & ToRs

- SADC Development Finance Resource Centre and SADC DFI-Network with the financial assistance from German Development Agency (GIZ), commissioned the Scan on SADC Development Finance Institutions and Environment.

- The purpose of this study is to:

  1) Document the current state of development finance in the SADC region and in particular those relating to policy, regulatory and legal environments of national DFIs;

  2) Identify and analyse the impediments and opportunities relating to cross-border activities by DFIs and recommending measures at national and regional level to address them;

  3) Assess the DFI Network mandate under FIP taking into account other structures such as SADC RDF, PPDF and PPPs;

  4) Propose policy options, framework and action plan to enhance the development of DFIs and their creditworthiness

Report

- The report of the Scan has 7 chapters and these include:

    1. Background;
    2. DFIs: International Context;
    3. DFIs: Sub-Saharan Context;
    4. Landscape of DFIs in SADC Region;
    5. DFI-Network Mandate under FIP;
    6. Challenges and Opportunities faced by DFIs; and
    7. Policy implications and Way forward

DFIs: International & African Contest.

- A development bank is a ‘bank’ or DFI established for the purpose of ‘financing development’.
- In this Scan, DFI is used to denote the development bank- reason being that a DFIs is more precise for public entity and “bank” normally tend to be private and licenced by the Central Bank
- These institutions play a crucial role in providing credit in the form of higher risk loans, equity positions and risk guarantee instruments to private sector investments.
- The DFIs also provide technical assistance.
- The DFIs thus fill a gap left by undeveloped capital markets and the failure of commercial banks to offer long-term financing

Experience of DFIs from international context. *Cont.*

- Prior to 1980 DFIs were considered to be financial institutions necessary to provide impetus to industrial growth.
- These institutions were used by the now developed countries like UK, Germany, USA, Japan, Korea to develop their countries.
- However, in the 1980s and 1990s the World Bank advocated for SAP and a two ties financial system was introduced with (i) licensed banks by Central Banks; and (ii) non-banks institutions not licensed by the Central Banks

Issues-International Context

- Banks licenced and supervised by the Central Bank did better
- DFIs due to lack of licencing and supervision continued to perform poorly and as a result many were closed.
- Poor performance of these DFIs has been mainly attributed factors such as:

  a) Institutional structure including ownership;
  b) Mandates;
  c) Funding arrangements & sustainability issues; and
  d) Corporate Governance.

Issues-International Context

- It is widely agreed that DFIs should play a complementary role in the financial sector;
- It is also believed that DFIs can only be sustainable & continue to play their development role if they:
  1. Are independent from excessive Government influence and control (key issue is ownership and independent supervision); and
  2. Have private sector ownership and independent management.

Issues from African perspective

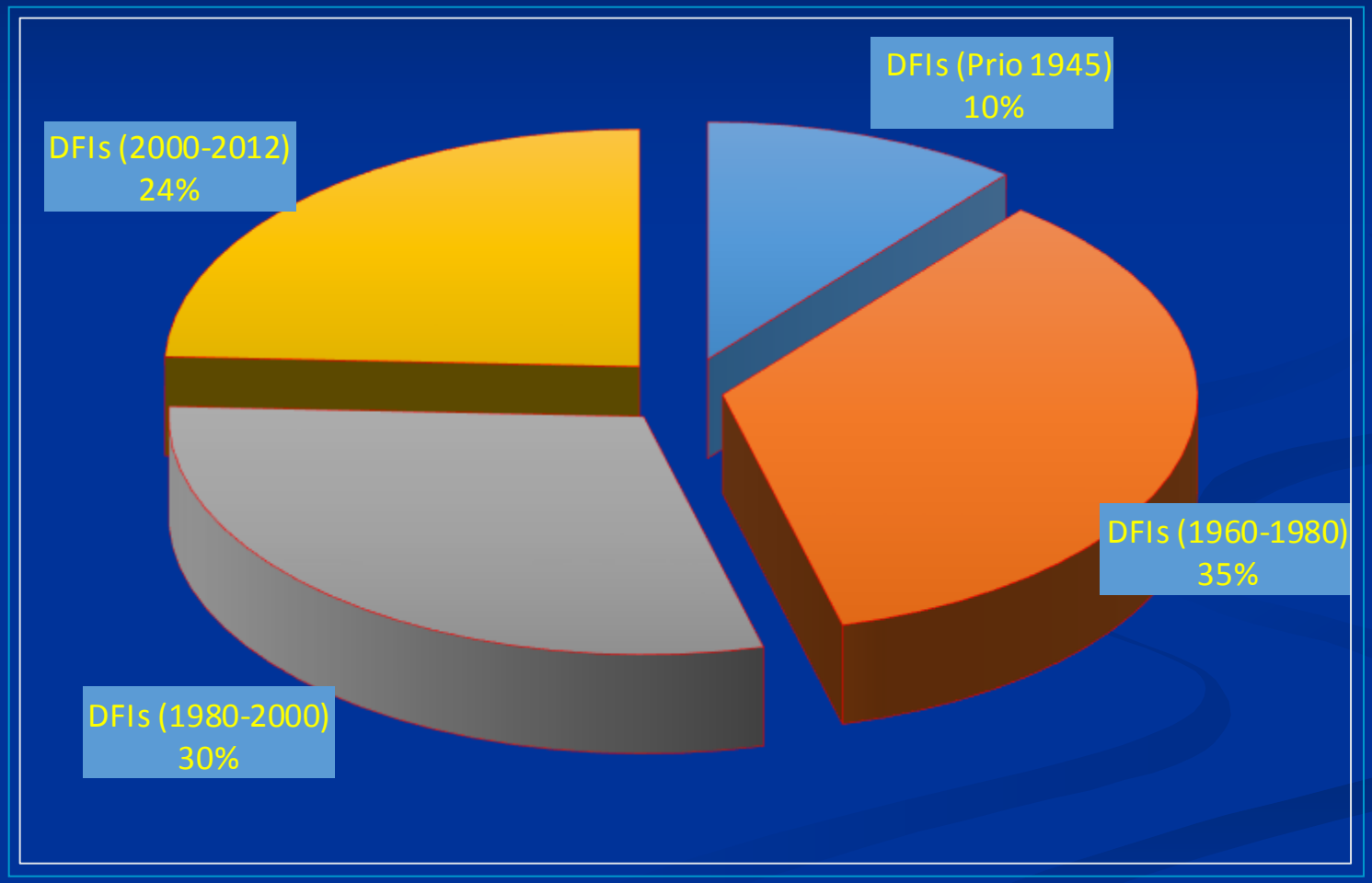
- Governments in Africa have continued to establish DFIs despite the problems attributed to these institutions.
- Currently there are over 147 DFIs in Africa (Bruck, 2003).
- Around 50 (34%) of these DFIs are in SADC region.
- These DFIs in general consist of: Universal Banks, Development Banks, Development Corporations, and Development Funds

Lessons: African perspective.

- DFI mandate was not recognised and therefore was not included in most financial reforms carried out in Africa;
- Reforms of 1990s contributed to a stable financial sector system (excluding DFIs);
- Products and services provided by former DFIs were only partially redistributed to the remaining financial sector system; and
- Many sectors of the economy still lacked long-term finance support

Scan Results on SADC DFIs

Period DFIs were Established



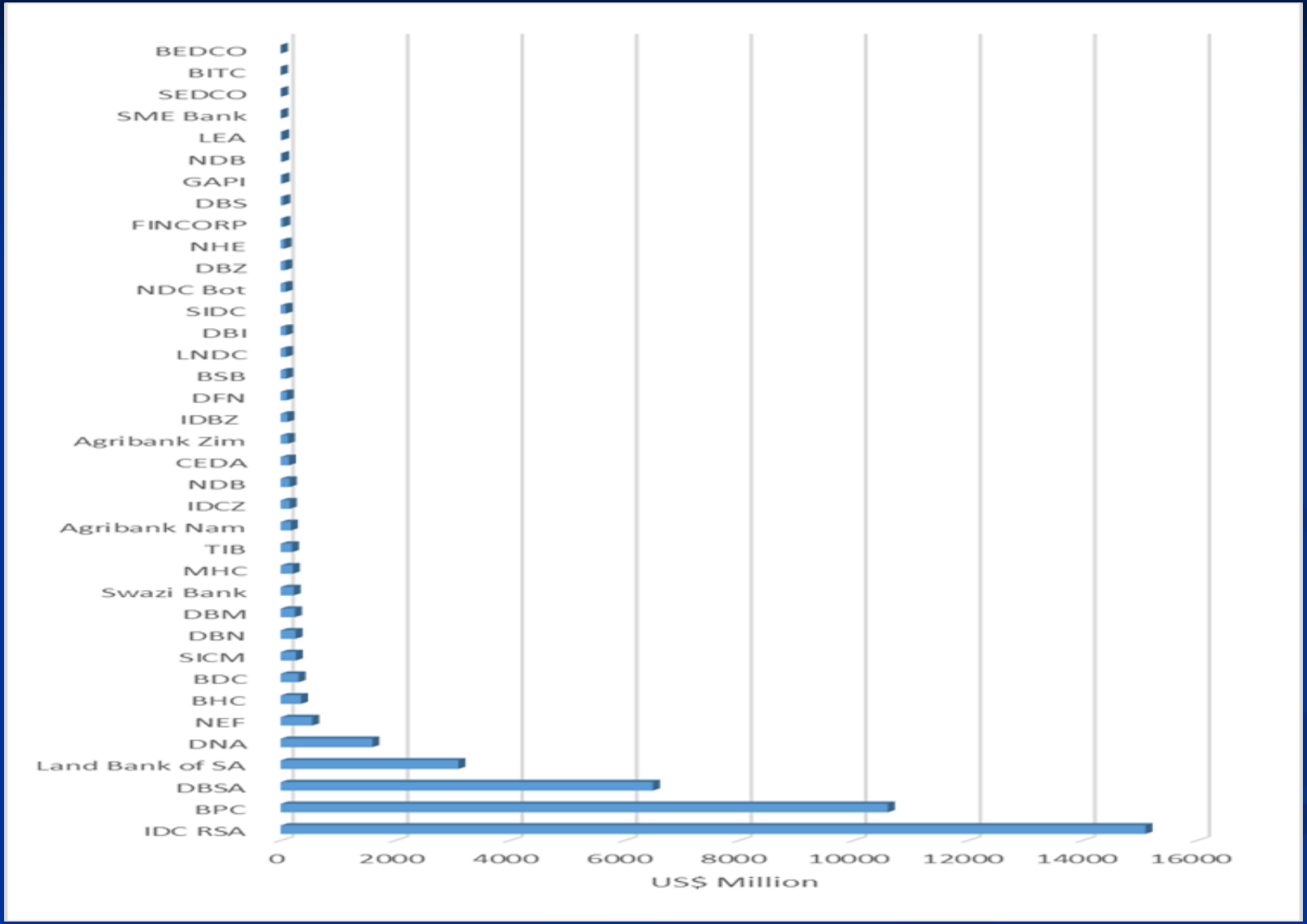
Implications for Period DFIs were established

1. The period shows an upward trend in the growth of DFIs despite the international institutions objections on these institutions.

2. This also shows the greet need for these institutions to fill up the gap which can not be serviced by commercial banks.

3. Thus there is need to ensure that these institutions are strengthened so that they can play their developmental role without giving much problems to the shareholders.

Results on SADC DFIs by Asset Size

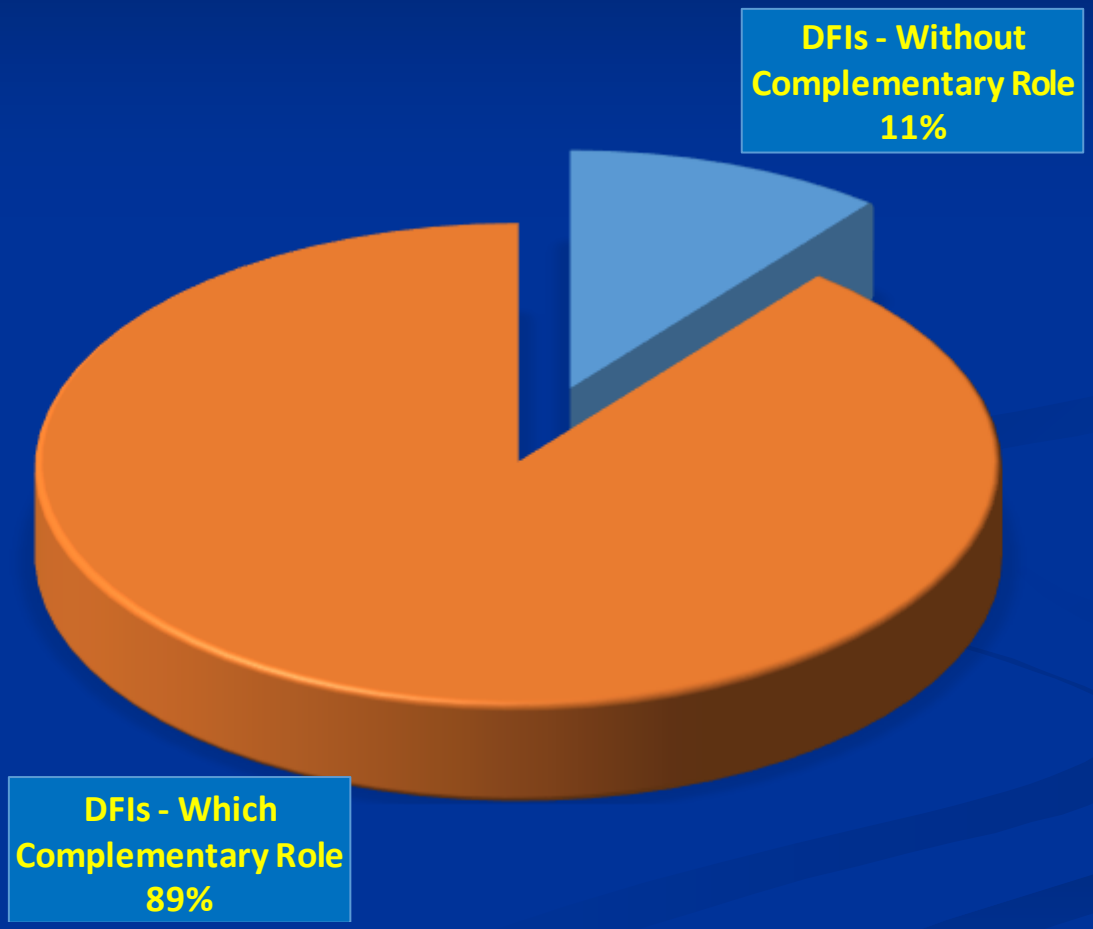


Implications of Asset Size on DFIs

1. It is clear from the graph above that most of the DFIs in the region are relatively small;
2. This has implication on volume of resources these DFIs can mobilise from the market; and
3. And also the economic sectors these institutions support;

- In short this makes it difficult for DFIs to access resources from the market .

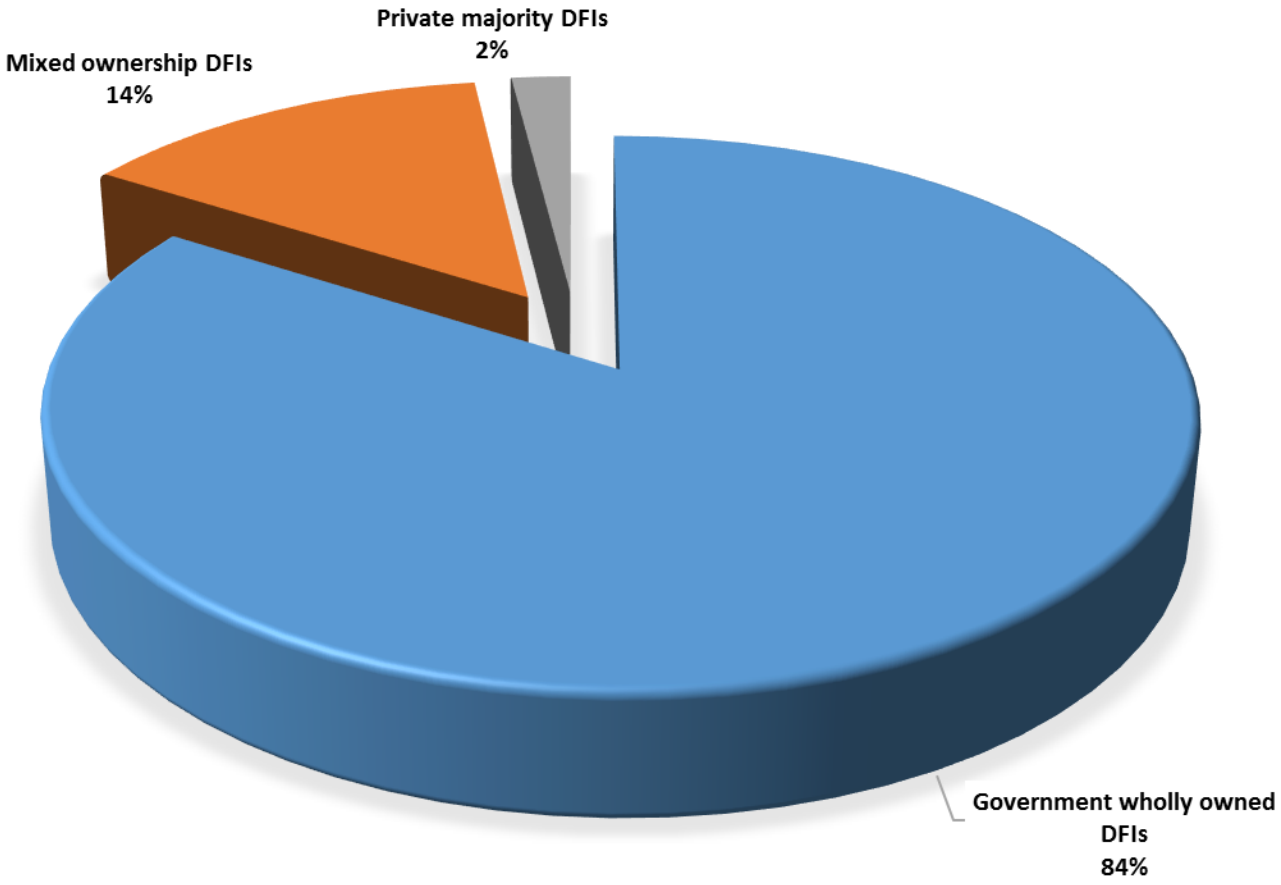
Results on Complementary Role of DFIs



Implication of complementarity

1. Reduce undue competition;
2. Lead to DFIs being more innovative;
3. DFIs developing more products;
4. Carry out more research and offer other support services;
5. DFIs focusing more on their niche position;
6. Contribute to the development of their respective countries; and
7. And also contribute to efficient utilisation of resources by the economy

Results on Ownership Structure of SADC DFIs



Implication on Ownership on DFIs

- Lack of strategic partners;
- DFIs can not crowd in private sector investment;
- Lack of operational efficiency which may come from the private sector initiatives;
- Lack of resources;
- Weak balance sheets etc.
- Poor Governance Issues

Results on Resource Mobilisation of Funding of DFIs

- The Scan found that DFIs sources of funding in SADC region include:

  i. Equity ;

  ii. Direct Government Support/budget support;

  iii. Debt instruments; and

  iv. Deposits.

Resource Mobilisation of Funding of DFIs

The Scan found that:

1. 89% of DFIs combine the options of funding with the bulk it coming from Government;

2) 27% of DFIs take deposits from the public;

3) 14% of DFIs had access to ICPs and Capital market resources; and

4) 8.6% of the resources were from the other DFIs.

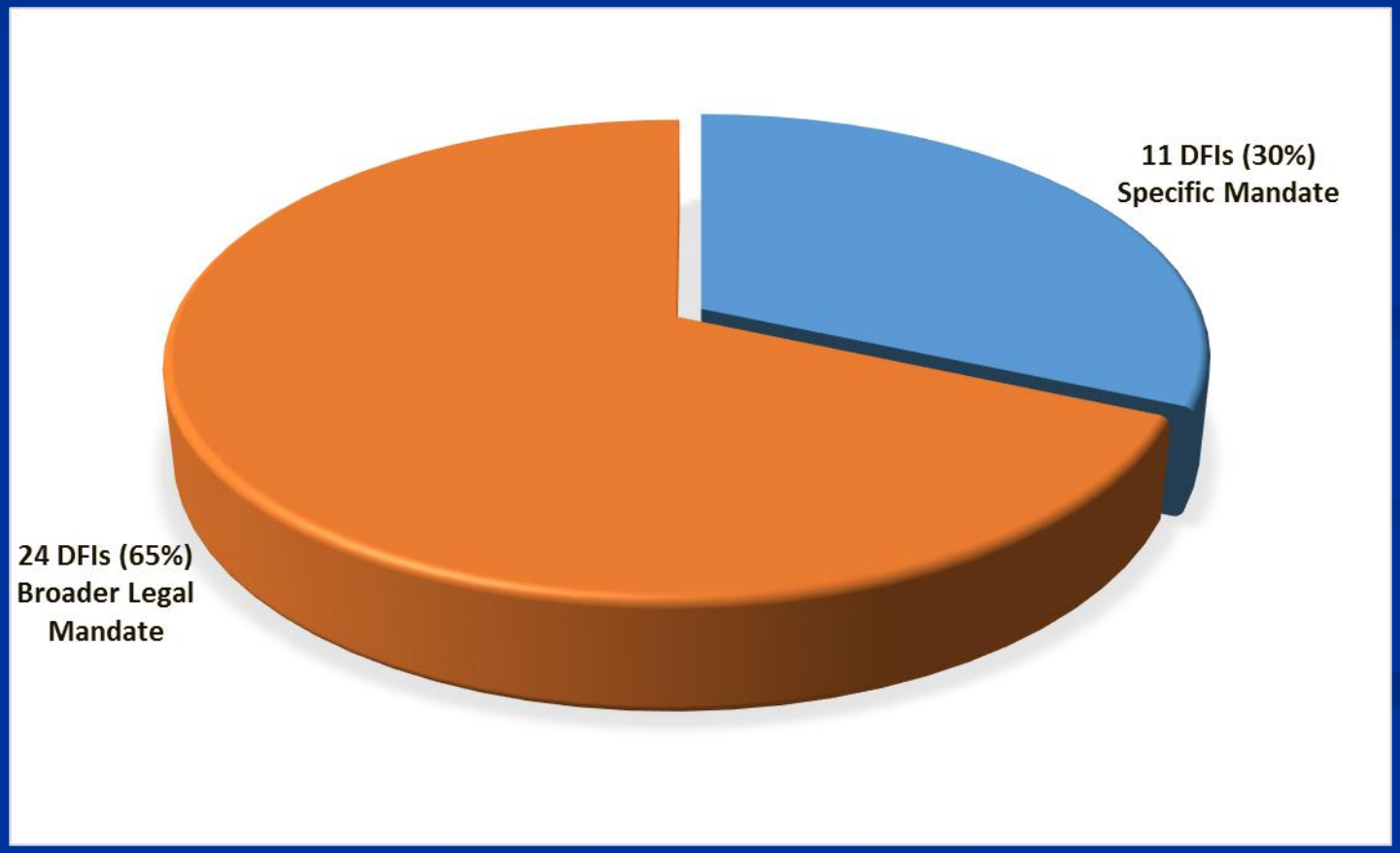
Implication on Resource Mobilisation of DFIs

- Because of the shallow base of resources for DFIs and overdependence on Government, the following are the implications:

  1. Bigger role of Government in the DFIs;
  2. Sustainability will remain an issue for the DFIs; and
  3. Capital markets will still remain under developed; and
  4. Failure on the part of SADC DFIs to borrow from the market due to lack of credit rating and weak balance sheets

Results on Mandates of SADC DFIs

- Mandates:

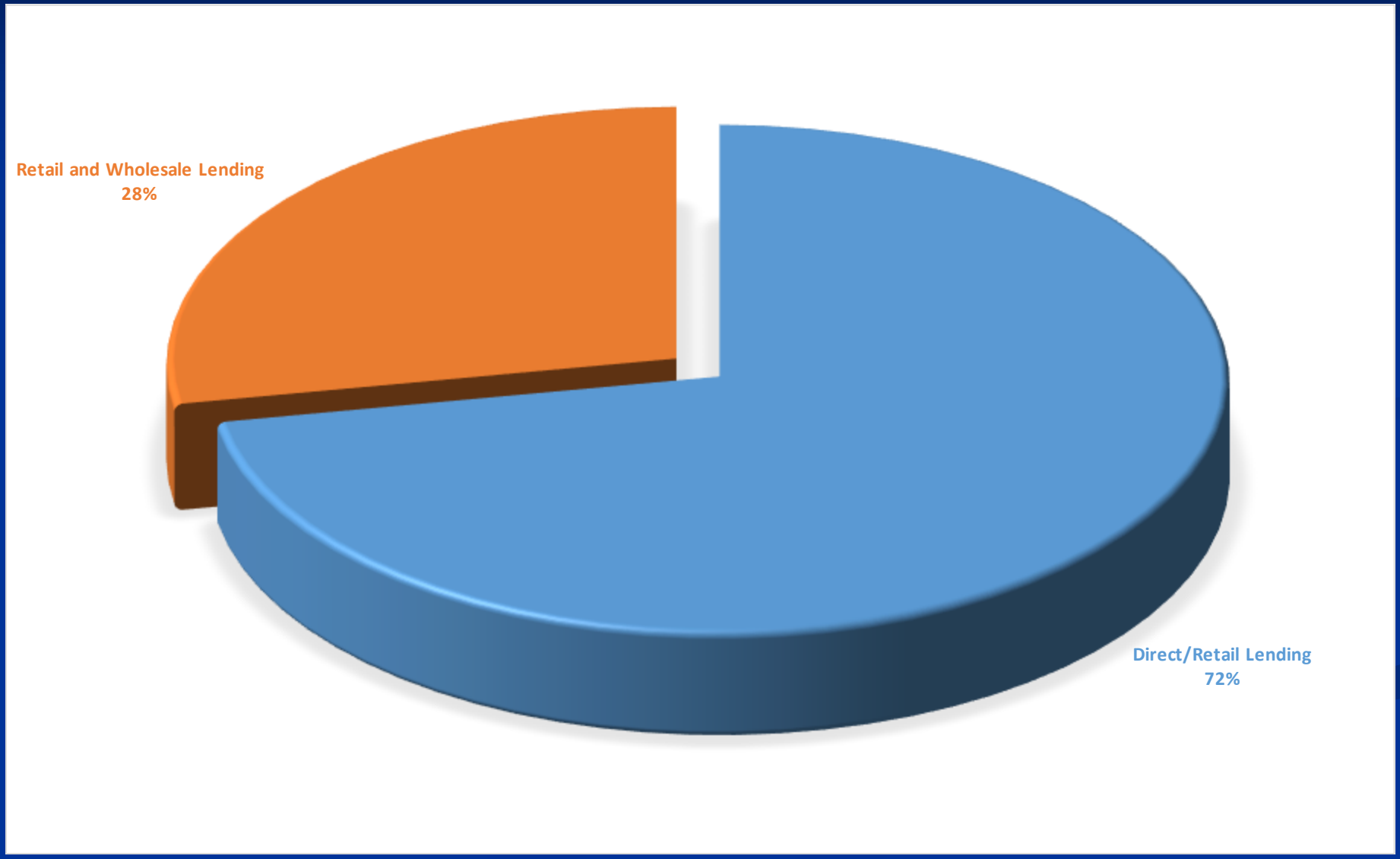


Implication on Mandates

- Considering the fact that most DFIs in the region have wider mandates with little resources may lead to:

  1. Failure on the part of DFIs to fulfil their mandates due to lack of resources;
  2. Government interference in the operations of the DFIs; and as a result;
  3. Mandate drift and shrink; and
  4. Lack of M&E mechanisms for DFIs

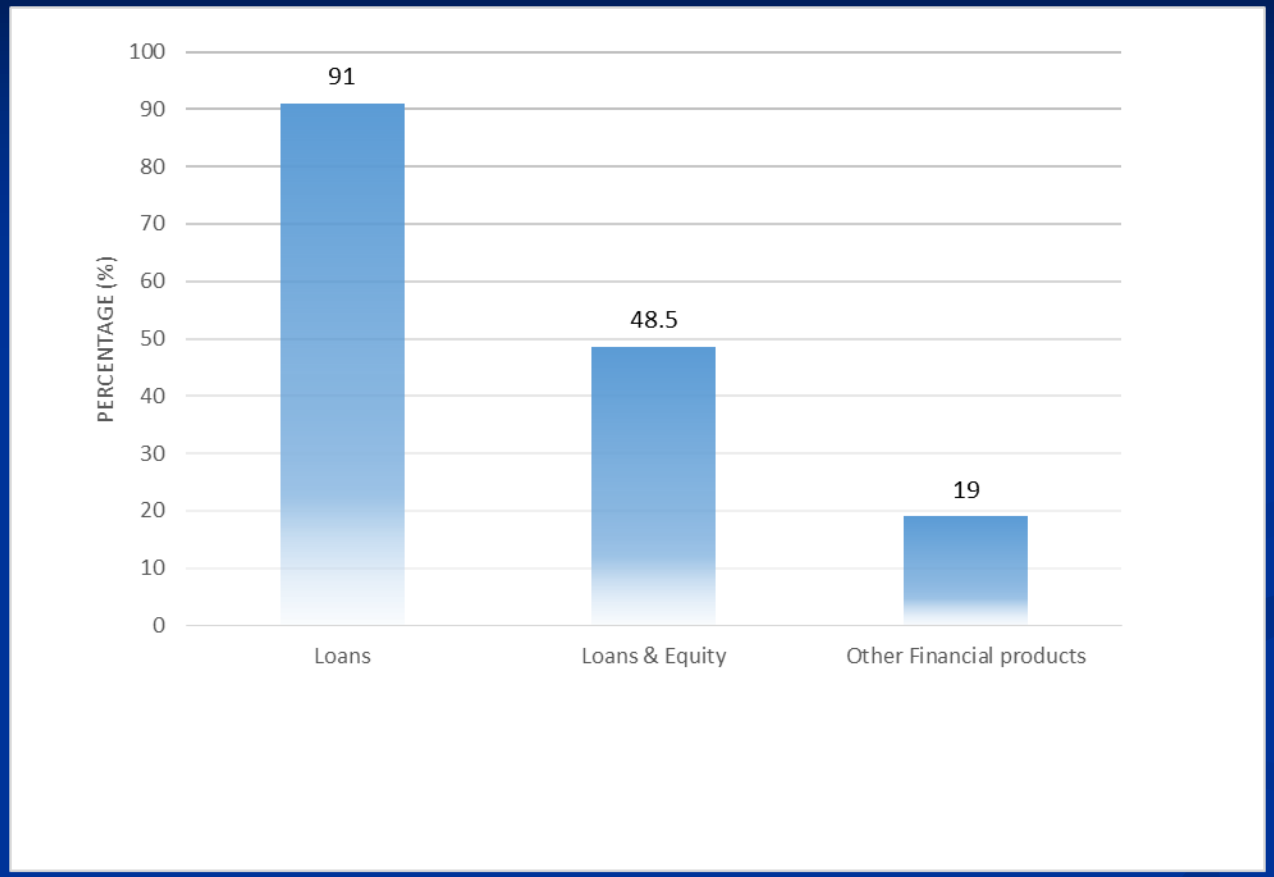
Results on Lending Models: First-Tier and Second-Tier Lending



Implication on Lending Model

1. The use of direct lending model has cost implications on the DFIs as this requires commercial bank expertise such as tellers;
2. On the other hand using wholesale lending model may reduce the cost on the DFI as the disbursement of the resources will be done by a third party.

Results on Financial Products by % Distribution



Implications of this are:

1. High Risk concentration; and
2. Low liquidity.

Results on Subsidized interest rates

- Provision of credit on concessionary rates by DFIs generates controversial issue.
- This is because the practice is thought to undermine the solvency and profitability of DFIs.
- For others, the use of subsidized interest rates is good – can be used to support entrepreneurs.
- 50% of sampled DFIs are said to offer credit at concessionary rate.
- Another 50% of DFIs offer it at competitive and even higher than commercial bank rates

Implication on Subsidies

- Implication in this regard may include:

1. This may on one hand lead low profitability of the DFIs if the price of the products is not correctly computed;
2. On the other hand this may also lead to more projects being financed by DFIs.

Results on Asset Quality

- Given the fact that profit maximisation is not the main objective of DFIs, their return on Assets and Equity tend to underperform the average return of the banking system.

- Thus the Scan results show:

  1. 40% of the sampled DFIs had their ROE greater than 3% average of commercial banks; and

  2. Also 24% of DFIs in the sample had ROA greater than 3%.

Asset Quality. *Cont.*

- On provision for NPL. Results as at end of 2012 show that:
  1. 37.8% of DFIs reported NPL ratios of less than 15% (commercial bank acceptable rate);
  2. 62.2% of DFIs recording NPL above the acceptable PSGRS rate of 15%.
- This result on NPL, ROE & ROA clearly show that assets quality for most DFIs in SADC region are poor/weak.

Implication on Asset Quality of on DFIs

The weak asset alluded to above may contribute to:

1. The decline in Government support as Government may not feel comfortable to support a DFI with huge problems;
2. Limited opportunities to raise Funds on capital market; and
3. May lead to problems of financial sustainability of the DFI

Corporate Governance Arrangements

- Good corporate governance is a critical factor for the success of DFIs.
- In broad terms, corporate governance is defined as "…the process and structure for overseeing the direction and management of a corporation so that it carries out its mandate and objectives effectively".
- Implementation of this can prove difficult for DFIs than private banks for a number of reasons.

Corporate Governance Arrangements. *Cont*.

- Results on the Board

  1. Board composition on average was found to be around 8 members;
  2. And most of these boards consist representatives from government (i.e., line ministries and even the CBs.)

- The Question then is, should these officials sit on these Boards?

- The answer is yes - provide strategic direction for the fulfilment of policy mandate.

Results on Corporate Governance Arrangements

- The Scan also finds that:
  1. 67% of DFIs require that board members have a minimum level of education;
  2. 70% require minimum technical qualifications in the banking field; and
  3. 65% require board members not to have bankruptcy records (i.e., not involved with institution which went bankrupt).
- In 98% of DFIs government retained power to appoint and fire board members and CEOs

Results on Corporate Governance Arrangements. Cont.

On Transparency of DFIs, the Scan found that.

- 90% of DFIs do provide information to the public.

Implications on Corporate Governance

Poor Governance may lead to:

1. Loss making;
2. Inefficiency;
3. Ineffective DFIs;
4. Under price risks;
5. Undermine competition; and
6. Weakened financial stability;

Regulation and Supervision of DFIs

- There are arguments for and against DFIs being regulated and supervised by Central Banks.
- The argument for is that in the event of financial problems in DFIs, the regulator will act using same preventive or remedial actions normally undertaken with private financial institutions.
- Counter argument is that this will kill the DFIs as CAR has a negative impact on DFIs lending during the recession period.

Results on Regulation and Supervision of DFIs. Cont.

- The study found that:
  1. 12 (32%) of DFIs are regulated by Central Banks;
  2. While the remaining 68% are un regulated.

PSGRS

- To bridge this gap of lack of a harmonised supervisory framework for DFIs PSGRS was developed in 2003 by AADFI and AfDB.
- The objectives of these guidelines are to assess compliance of DFIs with a set of internationally accepted corporate governance and operational standards.
- The guidelines are based on 100 questions grouped into three categories: governance standards, financial prudential standards and operational standards.

PSGRS. *Cont.*

	Result %	Rating
African Export and Import Bank (Egypt)	94	AA
East African Development Bank (Uganda)	93	
Credit Agricole du Maroc (Morocco)	93	
Odu'a Investment Company, Ltd. (Nigeria)	92	
Banque Nationale pour le Développement Economique (Burundi)	91	
Eximguaranty Co (GH) Limited (Ghana)	91	
Banque Rwandaise de Développement (Rwanda)	89	A +
SwaziBank (Swaziland)	89	
Industrial Development Corporation (South Africa)	88	
National Investment Bank(NIB)-(Ghana)	87	
Swaziland Development Finance Corporation (Swaziland)	87	
Development Bank of Namibia (Namibia)	86	
Citizen Entrepreneurial Development Agency (Botswana)	84	A
PTA Bank (Kenya)	84	
Nigerian Export-Import Bank (Nigeria)	83	
ECOWAS Bank (EBID) (Togo)	82	
Botswana Development Corporation (Botswana)	81	
Agricultural Development Bank	80	
Banque de l'Habitat de Cote d'Ivoire(BHCI) (Côte d'Ivoire)	80	
Banque de Développement des Etats de l'Afrique Centrale(BDEAC) (Congo)	80	

Results on PSGRS.

1. As shown in the preceding slide, there are a number of SADC DFIs using these guidelines.

2. Two of the MS have even formally adopted the guidelines as part of the regulatory framework of the DFIs.

- The remaining issues however are that these guidelines:

1. Have not formally been adopted by SADC MS;

2. Currently they are used as self-assessment tool;

3. No independent institution enforces the guidelines

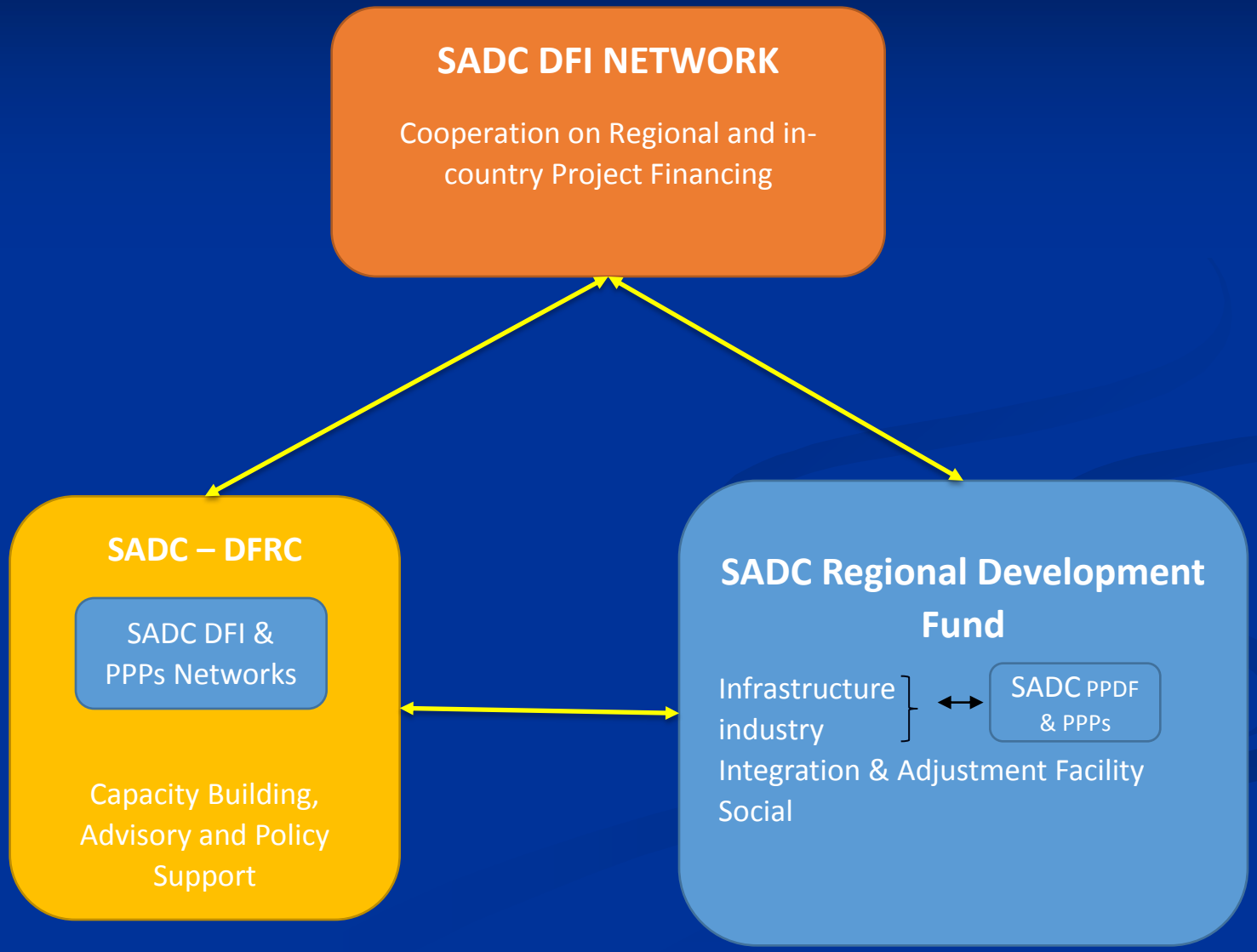
Implication on Regulations and Supervision of DFIs

- Poor performance of DFIs due to lack of:

  1. Harmonised regulatory policy framework for DFIs;
  2. Independent institution to enforces the guidelines; and
  3. Coordination framework at MS levels for DFIs

- Hence the need to develop the regulatory policy for DFIs in SADC region

DFI Network Mandate under FIP



DFI Network Mandate under FIP. *Cont.*

- SADC DFI Network is an institution established under the FIP in 2000 to contribute to the SADC agenda of regional integration.

- Its mandate is to:
  - promote collaboration and cooperation between the national development finance institutions in such areas:

    1. pooling resources for regional projects;
    2. taking equity in each other's institutions;
    3. investing jointly in new regional structures and collaborating on projects;
    4. capacity building;
    5. policy research; and
    6. strengthening information technology.

Results on DFI-Network

1. So far 4 DFIs in the regional have a regional mandate;
2. Little has been achieved on pooling of resources for regional projects;
3. 5% of DFIs sampled have taken equity in other DFIs;
4. SADC DF not yet operationalized;
5. DFIs have not collaborated on regional projects; and
6. Guarantee Scheme for SADC DFIs not yet put in place

Implication on DFI-Network

1. DFI Network to work together and mobilise resources for regional projects;
2. Regulatory environment for DFIs;
3. All the DFI structures should be coordinated by the network under SADC DFRC; and
4. Develop a plan for the Network on key issues affecting the members.

SADC DFRC

- SADC DFRC is the secretariat of the DFI-network and was established in July 2003 under the SADC principle of subsidiarity.
- The Network falls under the DFI Sub-committee that is accountable to the Ministers of Finance and Investment through the Senior Treasury Officials.
- Its mandate is to provide support to the DFI Network as coordinator and catalyst to improve the operational efficiency of its members.

Results on SADC DFRC

- So far SADC DFRC has made contributions to a number of initiatives such as:

1. Facilitating 112 training programmes and trained 3,086 personnel);
2. Offered technical assistance to DFIs e.g., Malawi, Zambia, Lesotho etc.;
3. Facilitated consensus building initiatives such as CEOs forum and DFI-Network bi-annual meetings;
4. Provided technical support to the operationalization of PPDF, PPP-Network, and SADC RDF

Implications for SADC DFRC

- While the response from Network members has been positive it was emphasised that:

1. Training was of greater value
2. It was also felt that more in-house training and advisory programmes which will deal with specific issues affecting DFIs should be prioritized by SADC DFRC.;
3. DFRC need to develop an Action Plan for the Network and also an M&E to monitor implementation of activities by DFI members.

The SADC PPDF

- The role of PPDF is to:

  1. provide funding for the preparation and development of regional projects, primarily infrastructure, to bankability; and through this

  2. establish of a pipeline of projects for financing for potential investors;

- This facility has been operationalized and currently being hosted by DBSA
- Unfortunately no project has been developed to date.

Implication on PPDF

- Need for SADC DFI Network to work closely with SADC Secretariat so that the facility can start operating;
- It is expected that PPDF will be subsumed under the infrastructure and Industry window once the Fund is fully operational;
- PPDF will also assist SADC DFIs to develop regional projects for the market

The PPP

- PPP is recognised as a vehicle for crowding in investment.
- And the main objectives for PPP is to facilitate co-operation on policies and other related issues among Private, Public and DFIs.

Implication on PPPs

- Need for SADC DFIs to develop PPPs capacity which can contribute to the PPP projects.

The SADC Development Fund

- The SADC RDF is a regional Fund or Bank.
- Its main purpose is provide a regional financing mechanism through which SADC will mobilize resources from Member States, Co-operating Partners and Private Sector.
- The operationalization of this institutional is currently at an advanced stage with two main issues still remaining to be agreed upon- Agreement and Option for subscription.

Implications of SADC DF

- The SADC DF will be the main instrument via which MS will mobilise resources for regional projects;
- The SADC DF will also take equity and supply resources for projects development in which national DFIs will be directly involved; and as result,

Implication

- SADC DFIs need to comply with international standards on Governance, regulation.

Challenges for DFIs

- There are a number of challenges faced by DFIs and these include:

1. Poor performance of projects;
2. Funding gaps;
3. Coordination of DFIs at national level;
4. Policy regulatory issues;
5. Competition from other financial institutions; and
6. Enterprise Risk on cross-border issues (lack of regional mandates and harmonised policies).

Opportunities for DFIs.

1. Funding high risk projects in sectors such as Agriculture, Infrastructure; Industrial, and SMEs
2. Develop local resource for long-term financing (e.g., using SADC DF);
3. Development of capital markets;
4. Influencing government policies; and
5. Facilitating cross-boarder investment (or regional projects).

Implications on challenges and opportunities

1. Room for reforms for National DFIs;
2. Use local capital markets to raise funds and also a means for exiting mature investments;
3. Need to reform the investment policies governing pension funds and other related investments;
4. Need to develop models (legal and regulatory policies);
5. Need to put in place the Regional guarantee scheme; &
6. Need to work closely with SADC Structures to facilitate operationalization of the SADC DF

Policy Recommendations

- The Scan proposes 8 recommendations and these include:

1. Rec. 1: Defining and Harmonising of DFI mandates;
2. Rec. 2: Enhancing Institutional Capacity and operational structure of DFIs;
3. Rec. 3: Enhance Performance Measurement of DFIs;
4. Rec. 4: Develop the framework for sourcing the Funds

Policy Recommendations. *Cont.*

- Rec. 5: Continue Government Support to the DFIs which should also involve coordination among all stakeholders;
- Rec. 6: Strengthen Corporate Governance;
- Rec. 7: Establish legal framework on regulatory and supervision of DFIs and this should include the financial policy framework; and
- Rec. 8: Single independent regulatory and supervisory body

Way Forward

1) Validation meeting with all members of DFIs August 2012;

2) Final Draft for adoption at the next DFI-Network meeting.

What Does this all mean?

SADC DFI Sector Reform Programme

Thank You

Lufeyo Banda