October 2001
IMF Country Report No. 01/189

Senegal: Financial System Stability Assessment, including Reports on the Observance of Standards and Codes on the following topics: Monetary and Financial Policy Transparency; and Securities Supervision

The Financial System Stability Assessment on Senegal was prepared by a staff team of the International Monetary Fund and the World Bank as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **August 24, 2001.** The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Senegal or the Executive Board of the IMF.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623 7430 • Telefax: (202) 623 7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

SENEGAL

Financial System Stability Assessment

Prepared by the Monetary and Exchange Affairs and African Departments

Approved by Stefan Ingves and G.E. Gondwe

August 24, 2001

This Financial System Stability Assessment (FSSA) is based on the work of the joint IMF/World Bank mission that visited Senegal as part of the Financial Sector Assessment Program (FSAP) in November 2000 and January 2001. The FSAP mission's findings were discussed with the authorities in July 2001 in the context of the 2001 Article IV Consultation. The FSAP team was composed of Piero Ugolini (IMF, Mission Chief), Anne Rennie (World Bank, Deputy Mission Chief), Mark Zelmer, Christine Sampic, and Sandra Marcelino (all IMF), Luc Cardinal, Carlos Cuevas, Elena Folkerts-Landau, Charlie Garrigues, Daria Goldstein, Gregorio Impavido, Andres Jaime (all World Bank), Kalidou Gadio (African Development Bank), Arnaud de Villepoix (Consultant-Banque de France), Brian Gelfand (Consultant-IOSCO), and Marcel Maes (Consultant-Belgium).

The banking system in Senegal has gradually regained health and is generally well regulated and supervised. The Senegalese authorities and the regional central bank, the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO), have addressed most of the problems that caused the banking crisis of the 1980s in order to avoid a repetition of similar problems. The lack of banking supervision has been successfully addressed by the creation of the regional Banking Commission followed by effective supervision. Government ownership and interference in the banking sector has been significantly reduced. However, the economy remains vulnerable to the same external and domestic policy factors (e.g., prices on oil, groundnuts, and domestic energy), which, in turn, could affect the stability of the banking system. This vulnerability is compounded by the high concentration of credit risk in bank loan portfolios and emerging inefficiencies in the judicial system related to the foreclosure process. Notwithstanding these vulnerabilities, the probability of a major systemic crisis is low, insofar as there is the capacity of the public enterprises or the government to repay bank loans.

Other financial sectors (insurance, pension, microfinance, and capital markets) are fairly small and at an early stage of development, and thus do not constitute a source of systemic risk even though they all suffer from a number of weaknesses. Owing to a limited regional interbank market, liquidity does not flow smoothly across the member countries of the West African Economic and Monetary Union (WAEMU), but there have not been any liquidity crises. The current obsolete manual payment system is being replaced by a new system that will comply with international standards by 2002. No systemic risks were found in this area, inasmuch as most transactions are conducted using cash. Since Senegal is a member of the WAEMU region, monetary policy and financial sector supervision are conducted for the region as a whole by regional institutions. Therefore, the assessments made in the context of Senegal apply for the region as a whole. There was partial observance of IOSCO principles. The transparency of monetary policy is satisfactory overall. A preliminary assessment of the Basel Core Principles was made.

Areas that need to be addressed to strengthen the financial sector further are: domestic pricing policy, the legal framework, and the high concentration of credit risk. In the future, strict coordination between the BCEAO and Ministry of Finance to facilitate the management of public debt will be required when Senegal and other countries in the region begin issuing public debt in the market. Action in this latter area is already under way.

This report was prepared by Piero Ugolini and Mark Zelmer.

Table of Contents

Page

Text Tables

Figures

Appendices

Glossary

AT/CPEC	Assistance Technique aux Caisses Populaires d'Epargne et de Crédit
ADB	African Development Bank
BCEAO	Banque Centrale des États de l'Afrique de l'Ouest
BRVM	Bourse Régionale des Valeurs Mobilières
CIMA	Conférence Interafricaine des Marchés Publics d'Assurance
CIPRES	Conférence Interafricaine de la Prévoyance Sociale
CRCA	Commission Régionale de Contrôle d'Assurance
CREPMF	Commission Régionale de l'Épargne Publique et des Marchés Financiers
DC/BR	Dépositaire Central/Banque de Règlement
DNA	Direction Nationale des Assurances
FATAF	Financial Action Task Force
FDIC	Federal Deposit Insurance Corporation
FNR	Fond National de Retraite
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
GDDS	General Data Dissemination System
IAIS	International Association of Insurance Supervisors
ICS	Industries Chimiques du Sénégal
IOSCO	International Organization of Securities Commissions
IPRES	Institution de Prévoyance Retraite du Sénégal
MFI	Microfinance institutions
MFP	Monetary and Financial Policies
NBFI	Nonbank financial institutions
OHADA	Organisation pour l'Harmonisation en Afrique du Droit des Affaires
SAR	Société Africaine de Raffinage
SDDS	Special Data Dissemination Standard
SENELEC	Société Nationale d'Électricité
SGP	Société de Gestion de Patrimonie
SODEFITEX	Société de Développement des Fibres Textiles
SONACOS	Société Nationale de Commercialisation des Oléagineux du Sénégal
SRO	Self-Regulatory Organization
SNR	Société Nationale de Recouvrement
WAEMU	West African Economic and Monetary Union
WAMU	West African Monetary Union

Overall Assessment

1. **Senegal's financial sector is dominated by ten commercial banks, which account for more than 85 percent of total financial sector assets.** Banks controlled by international financial conglomerates make up almost 80 percent of banking system assets. Insurance companies account for most of the remainder of total financial sector assets, and there is an embryonic securities market. Microfinance institutions' activities are growing very rapidly and reaching an increasing share of households, small enterprises, and informal sector business. With the exception of the regional development bank, the African Development Bank (ADB), there are no development financial institutions operating in Senegal, but there are two banks that specialize in providing agricultural credit and housing loans, respectively.

2. **The *banking system* in Senegal has gradually regained health and is generally well regulated and supervised.** However, nonperforming loans, as a share of total private sector loans, albeit relatively low, are on the rise. The Senegalese authorities and the regional central bank, the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO), have addressed most of the problems that caused the banking crisis of the 1980s in order to avoid a repetition of similar problems. The Senegalese authorities' objective is to build a stronger financial sector capable of supporting a higher rate of economic growth necessary to reduce poverty and unemployment as part of the PRGF program. As of April 2001, financial sector assets represented 39 percent of GDP.

3. **The major vulnerabilities of the past fall into four main categories: (i) lack of supervision; (ii) substantial government ownership and interference in the banking sector; (iii) a narrow economic base, which left the country and its financial system highly exposed to shocks in the areas of groundnut production, export and petroleum import prices; and (iv) the effects of some government policies in the setting of producer prices for groundnuts and domestic energy prices.** The lack of supervision has been successfully addressed by the creation of the regional Banking Commission and effective supervision. Government shareholdings in the banking sector and interference in the day-to-day management of banks have been significantly reduced. However, the economy continues to remain vulnerable to external shocks and government policies in the setting of producer prices for groundnuts and domestic energy prices, which, in turn, could seriously affect the stability of the financial system. This vulnerability is compounded by the high concentration of credit risk in bank loan portfolios.

4. **The high concentration of credit risk in bank loan portfolios is unavoidable given that banks have little scope for further portfolio diversification.** In addition, the banks are earning wide spreads in their current lending activities that are mainly focused on loans to the largest enterprises. While wide spreads make it easier for the banks to absorb external shocks, they may reduce the incentive to seek out lending opportunities that may exist among small- and medium-sized businesses and the household sector. (This may partly explain the growing microfinance sector). Moreover, risks associated with lending to the latter are high due to some problems in the legal system (discussed below) and the lack of reliable information on the financial condition of prospective borrowers because of existing problems in the accounting and corporate governance systems. The problems encountered by the banks' exposures to SONACOS and SENELEC in 2001 are clear examples of the potential vulnerabilities that exist in the banking sector. These are highlighted in the stress test exercise.

5. **Notwithstanding these vulnerabilities, the mission is of the view that the probability of a major systemic crisis is low.** A number of major factors contribute to the resilience of the system. They are: (i) the introduction of permanent, systematic supervision mechanisms; (ii) enhanced governance; (iii) modernization of bank management; (iv) regulation of financial activities at the regional level; and (v) the implementation of preventive policies. Additional factors are the membership of Senegal in the West African Economic and Monetary Union (WAEMU), which ensures that shocks to Senegal are not compounded by inflation and exchange rate uncertainties, and the low level of monetization in Senegal. Finally, the embryonic state of the interbank market, and the current high level of liquidity in the banking system make a contagion effect in the event of a bank failure unlikely. There remains, however, a risk of contagion from the banking sector to other financial subsectors, since both insurance companies and microfinance institutions maintain large deposits with the banks.

6. **Other sectors of the financial system in Senegal are fairly small and underdeveloped, and thus do not pose major sources of systemic risk.** ***Insurance companies***, which account for 10 percent of total financial assets, present a number of weaknesses: low minimum capital; weak licensing procedures; lack of internal control procedures; little use of reinsurance; and a lack of on-site inspectors. In addition, the ability of insurance companies and pension funds to invest in a diversified range of longer-term investments is hindered by a lack of suitable domestic investments and the difficulty of investing offshore because of existing arrangements surrounding the convertibility guarantee of the CFA franc, which effectively preclude such investment. As a general rule, the larger companies appear to be profitable, while the smaller ones are encountering difficulties.

7. **While the *pension system* in Senegal does not pose systemic risks for the financial system, its current financial position is unsustainable in the medium and long term, and may have a significant budgetary impact if fundamental reforms are not undertaken.** The Senegalese government is well aware of this problem and has made pension system reform one of its priorities.

8. ***Capital markets*. The regional stock exchange in Abidjan is a relatively new component of the financial system in the WAEMU, having commenced operation in September 1998.** Senegal has only one company listed on the exchange. At this stage of development, the financial market has not yet reached the volume of activity necessary to cover all of its operating costs, including those of the supervisory system. In addition, owing to this low level of activity, intermediation costs are high, which further limits the market's liquidity.

9. ***Microfinance* development in Senegal has kept pace with the dynamic evolution of this sector in the WAEMU region.** In Senegal, the number of institutions and their membership has reportedly grown to about 18 percent of the households. Deposit balances in microfinance institutions (MFIs) have increased in relative importance vis-à-vis bank deposits from the equivalent of 1 percent in 1996 to 2.4 percent as of June 2000. Aside from the three dominant MFIs, there are a large number of entities with small membership and weak institutional structures. The lack of appropriate supervision framework is the key problem.

10. **The *legal framework* governing the financial sector in Senegal is quite comprehensive, covering most areas.** However, the functioning of the Senegalese judicial

system, which has traditionally been recognized as quite satisfactory, is currently becoming a matter of some concern, since delays in the foreclosure process compound the credit risk in the financial system. The development of the justice system in Senegal has not kept pace with the growth of the financial sector. Several factors need attention: (i) the system can be quite slow; (ii) the judicial infrastructure is inefficient; (iii) no modern information system exists to collect all relevant information regarding court cases; and, (iv) on the whole, decisions are not systematically published. The financial community is now often critical of the functioning of the judicial system, especially certain banks, which have expressed doubts about the competency and the quality of the decisions of some judges in financial matters.

11. ***Liquidity management*. Owing to the small number of intraregional interbank operations (with the exception of intragroup operations), liquidity does not flow smoothly across the member countries of the Union, and the BCEAO does not engage in regular open market operations.** Reserve requirements are at times used to manage liquidity in each country. Reserve ratios are not uniform across the Union and Senegal's ratio, at 9 percent, is one of the highest in the region. There have not been any liquidity crises.

12. **The current manual *payment system* is slow and obsolete. It does not meet the needs of a modern economy or an active interbank market.** The weaknesses of the system have been clearly identified by the BCEAO, which has launched a reform project at the regional level with the help of the World Bank, to establish a system that complies with international standards by 2002. Despite the weaknesses of the current system, no systemic risks were found by the mission since most transactions in the economy are conducted in cash.

Compliance with international standards and codes

13. Since Senegal is a member of the WAEMU region, monetary policy and financial sector supervision are conducted for the region as a whole by regional institutions. Therefore, the assessments made in the context of Senegal apply for the region as a whole.

– ***Basel Core Principles*:** Only a preliminary assessment was made. A final assessment is envisaged to be made in the context of the forthcoming FSAP mission to Côte d'Ivoire. Appendix I summarizes the main findings. **The banking supervision system has improved significantly in recent years**: a system of accounts has been introduced; new circulars call for internal control and audit functions to be strengthened; and the prudential system sets new licensing requirements and management standards, including capital adequacy and risk coverage standards. Moreover, a circular letter on corporate governance was issued recently. In the case of money laundering, work is under way to introduce legislation on a regional basis in this area by 2002.

– ***IOSCO*: Although the regulatory and supervisory framework for the financial market is quite new, a regulatory and supervisory system is already operational.** This system generally observes the objectives and principles for financial regulation established by IOSCO, since most of these principles are fully or partially applied. However, some key principles are not, especially in the following areas: supervision of the secondary market, prudential regulations and management of the risks of intermediaries, and exchange of information and instances of coordination with other regulators.

– *Monetary transparency*: **The transparency of monetary policy in the WAEMU is satisfactory overall.** Since the establishment of the Union in 1973, its governing laws have set out the general objectives and framework for the implementation of monetary policy so that all member states can have a clear view of the policy directions taken. In recent years, the BCEAO has endeavored to improve the readability of its monetary policy and the information provided to the public on its mission, objectives, main activities, and decisions. Commercial bank representatives believe that the transparency process could be enhanced by increasing the frequency of consultation. The BCEAO officials noted that meetings with the National Director (about three times a year) are held on a regular basis, and bilateral meetings are organized upon demand. In addition, the governor meets once a year with all of the regional bankers' associations.

14. **In order to cope with future challenges, the Senegalese authorities and the BCEAO have embarked on a series of steps aimed at further strengthening the macroeconomic framework and the soundness of the financial sector.** These include: (a) continuing to implement prudent fiscal and monetary policies and addressing regulated domestic price policies; (b) increasing the level of openness and transparency in economic and financial decisions and activities; (c) eliminating direct central bank financing of the government and developing a regional government securities market; (d) introducing a modern payment system; (e) promoting the development of an active regional money and capital market; (f) improving the implementation of laws; and (g) strengthening the supervision of insurance and microfinance institutions and the financial market. **While these efforts are to be commended, additional areas need to be addressed to further strengthen the financial system.**

a. **Legal framework: The slowness and growing inefficiency of the judicial system is a matter of serious concern.** Additional human and technical resources, as well as training and specialization of court officials, should be provided to correct the problem.

b. **The banking system remains exposed to the high concentration of credit risk, in particular for indigenous banks that have little scope for further portfolio diversification.** The authorities should make efforts to alleviate the concentration of credit risk in bank loan portfolios by more rigorous application of prudential limits on risk concentration. In addition, consideration should be given to introducing credit bureaus that could gather and disseminate information on prospective borrowers.

c. **In the case of banks in serious or irreversible difficulties, rapid action by the supervisory authority can be critical to ensure depositor protection.** In this regard, the role played by the national Ministers of Finance in the appointment of temporary administrators or notification of the withdrawal of a license, and the suspensive effect of possible actions are not very well suited to specific situations. Once a deposit insurance system is in place, the authorities should plan to transfer all responsibility for the appointment of temporary administrators and notification of the withdrawal of licenses to the Banking Commission in order to improve the efficiency of the supervisory authority.

d. **For the insurance sector, fit and proper tests should be implemented, minimum capital increased, principles of corporate governance and internal controls applied, reinsurance encouraged, and resources allocated to supervisory agencies augmented so as to increase the frequency and scope of on-site inspections.**

e. **The BCEAO has made significant progress in disseminating regulations, information, and laws related to the financial sector.** However, representatives of the financial sector told the mission that they would like to **meet more frequently** to exchange views on issues of common interest.

f. **Quick changes need to be made to the benefits of the pension system, while continuing the analysis and dialogue on its structural reform.** Parameters in need of change include: enlarging the contribution base, strengthening the link between contributions and benefits, and tightening entitlement rules.

g. **Microfinance in Senegal is a growing sector, which serves a very large segment of the population, in particular low-income groups and the informal sector.** However, the growing number of institutions has created problems of supervision. The licensing of new institutions should be closely monitored until an assessment of the state and performance of existing institutions can be made. The advisability of evaluating the creation of a special supervisory body should be evaluated and coordinated with the interested parties.

h. **The development of an efficient payment system, together with better circulation of information and communication among banks in the region and the creation of standard instruments (such as repurchase agreements), are essential to improve the liquidity management system.** The efforts to fully develop a **regional interbank market** are strongly supported. The ongoing modernization of the payment system will be the first step in achieving such a goal. Additional measures (such as the use of collateral) and initiatives to encourage the exchange of information and communication among banks and countries in the region will be essential for its development. More frequent use of open market operations to adjust short-term liquidity fluctuations would be desirable once that government securities are introduced in the union. Close cooperation between the BCEAO and the Ministry of Finance to facilitate the **management of public debt** in the future is welcomed and encouraged.

i. The authorities should make efforts to reach full compliance with all of the international standards and codes.

SECTION I—STAFF REPORT ON FINANCIAL SECTOR ISSUES

I. Financial Sector in Senegal

15. The financial sector consists of 10 commercial banks, 4 nonbank financial institutions (NBFIs), a government-owned postal savings network, 5 life insurance companies, and 10 "non-life" ones, and about 500 microfinance institutions. Almost all institutions are privately owned—in the case of most of the large banks by foreign banking conglomerates—even though the government still holds almost 25 percent of the capital of three commercial banks. There are also two local pension schemes—Fond National de Retraite (FNR) and the Institution de Prévoyance Retraite du Sénégal (IPRES)—and a region-wide social security system (CIPRES). However, they only serve a small portion of the population. The local capital market mainly consists of an interbank market that primarily deals on an overnight basis; there is also a regional securities market headquartered in Abidjan, Côte d'Ivoire, serving the WAEMU region. The BCEAO is working with the financial sector to introduce a real-time gross settlement payment system for the region.

16. The degree of financial development in Senegal is low. For example, M2 as a percent of GDP was about 25 percent in the WAEMU region in 2000 compared to 57 percent in South Africa. It is nonetheless higher than in the Central African Economic and Monetary Community (less than 10 percent in 2000). The financial sector is dominated by the banks, which control more than 85 percent of financial sector assets (Table 1), although the registered microfinance institutions have grown rapidly over the past several years, and numbered 492 institutions (June 2000), with total credit outstanding of CFAF 15.8 billion (US$25 million equivalent) and total deposits of CFAF 17.2 billion (US$27 million equivalent). There are also a large number of informal savings groups.

Table 1. Senegal: Total Assets of Financial Institutions

(As of April 2001)

Institutions	CFAF (In Billion)	Percent of Total	Percent of 2000 GDP
Banks	1,075.2	88.5	34.6
Nonbank financial institutions 1/	12.1	1.0	0.4
Insurance companies 1/	114.0	9.4	3.7
Microfinance institutions 1/ 2/	13.6	1.1	0.4
Total	1,214.9	100.0	39.1

Sources: Senegalese authorities and Fund staff estimates.

1/Only information for December 1999 is available.

2/Total deposit liabilities, since data on total assets were not available.

17. Following the financial crisis at the end of the 1980s, WAEMU members introduced modern laws and regulations to supervise the activities of commercial banks and other credit-granting institutions. As part of this endeavor, the WAEMU Banking Commission was created to supervise the 91 banking institutions operating in the region. It is composed of representatives

from each state of the Union, and chaired by the Governor of the BCEAO. The Secretary General of the Banking Commission is responsible for implementing decisions and recommendations with the help of staff that have been seconded from the BCEAO.

18. Other regional financial system supervisory bodies include: the Commission Régionale de Contrôle d'Assurance (CRCA), which was founded in 1992 to supervise the insurance industry; and the Conseil Régional de l'Épargne Publique et des Marchés Financiers (CREPMF), the main regulatory and supervisory body for the securities market, which was established in November 1997. Microfinance institutions are supervised on a national basis by the Cellule (Unit) AT/CPEC at the Ministry of Economy and Finance.

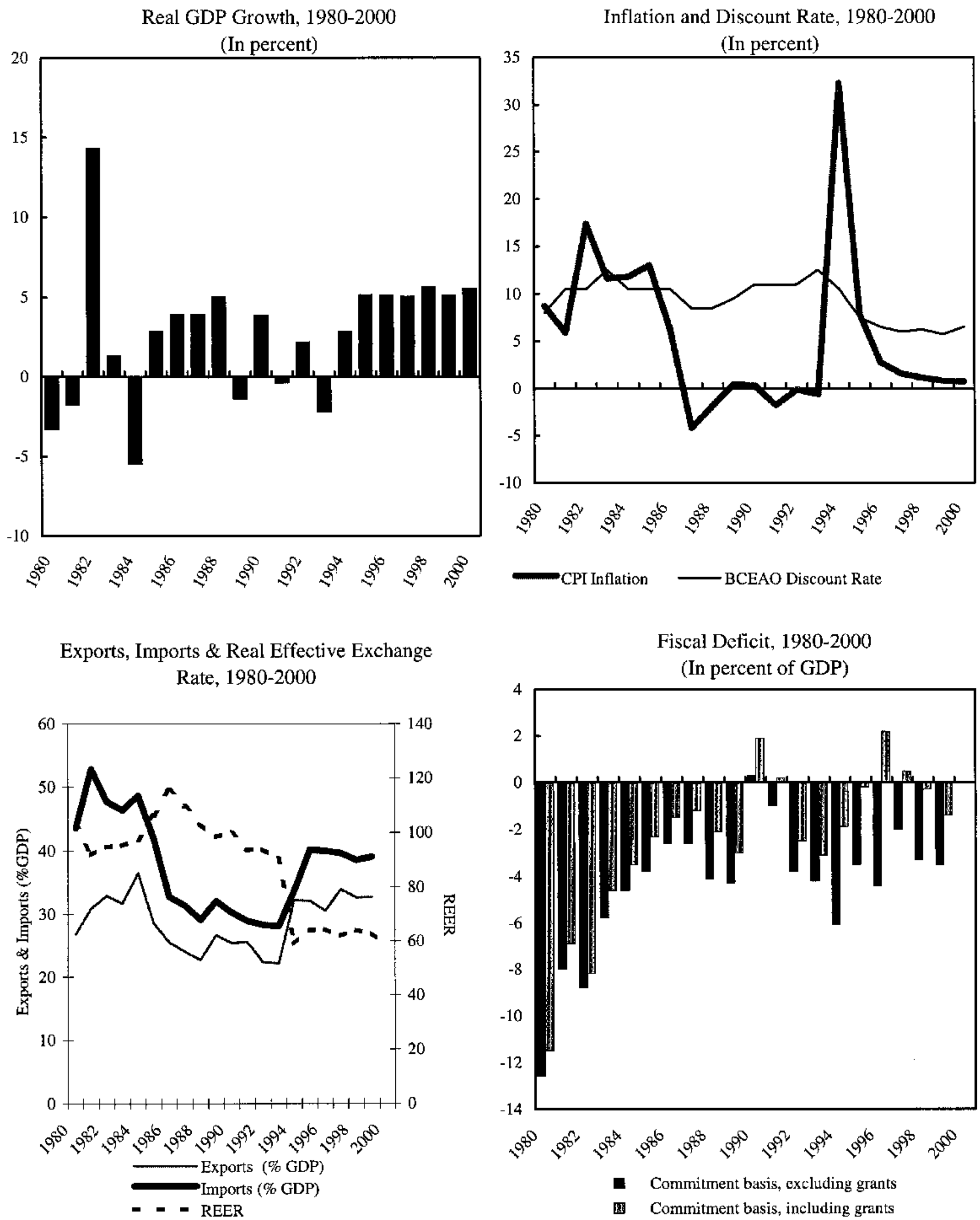
II. Macroeconomic Factors Affecting the Health of the Financial System

19. Senegal is the second largest member of the eight-country WAEMU region, accounting for about 17 percent of the Union's economic activity. However, the overall level of development in Senegal is low, with a per capita income of about US$500 in 2000. WAEMU members share a central bank, the BCEAO, whose currency the CFA franc, has been pegged to the euro under a special convertibility arrangement with the French Treasury. This arrangement helps to protect the financial system from volatile capital flows, since the banks are not allowed to carry significant open foreign exchange positions and domestic investors are not allowed to invest offshore. Monetary policy is conducted at the regional level by the BCEAO with the objective of sustaining price stability and maintaining the fixed exchange rate with the euro. The WAEMU institutional framework provides for convergence criteria, among others, on the primary fiscal surplus, nonaccumulation of arrears, and the wage bill as a percentage of fiscal revenue to complement the guaranteed convertibility by the French Treasury.

20. Real GDP growth has averaged about 5 percent annually since the mid-1990s, after having experienced a period of sluggish growth in the late 1980s/early 1990s (Figure 1). The exchange rate realignment of January 1994 led to a significant turnaround in economic activity, with output, exports, and investment increasing rapidly in the latter half of the 1990s. Inflation, after a brief surge in the aftermath of the devaluation, has returned to low levels. Good economic management, the continued implementation of structural reforms, and the remaining positive effects of the CFA franc devaluation stimulated the Senegalese economy over the period. Following the devaluation, private sector credit initially contracted as banks wrote-down their bad loans, but has since recovered. Broad money grew in line with the growth in nominal GDP until 1998 (Figure 2), but accelerated in 1999 and 2000. This led the BCEAO to tighten its monetary policy stance in August 2000—the intervention rate was raised by 75 basis points in June 2000, and commercial bank reserve requirements in Senegal were increased from 3 percent to 9 percent—to keep inflation low.

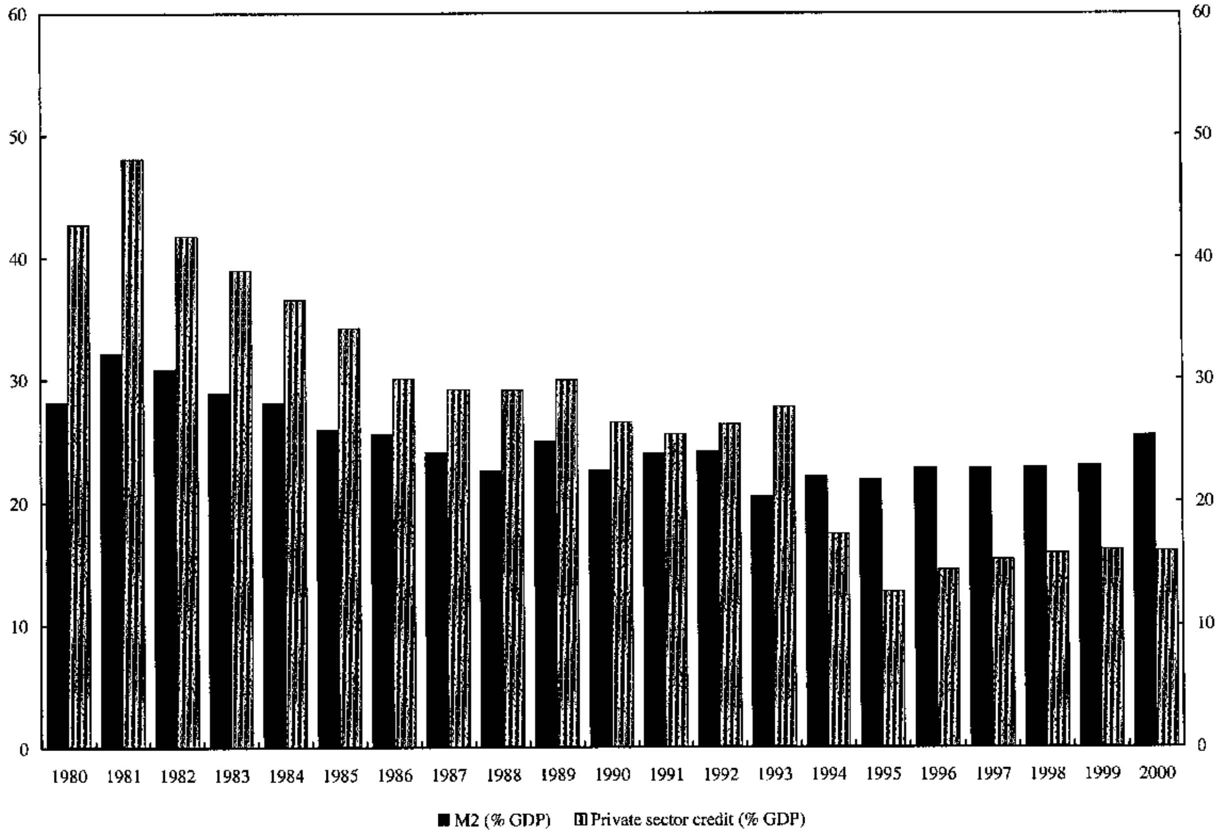
21. Despite the favorable economic performance observed in recent years, the country's narrow economic base leaves it vulnerable to macroeconomic shocks. The major shocks that often affect Senegal are: unexpected declines in prices of key export commodities (groundnut-, phosphate-, and fish-related products constitute more than one-third of total exports); higher oil

Figure 1. Senegal: Macroeconomic Indicators



Sources: Senegalese authorities; and Fund staff estimates.

Figure 2. Senegal: Broad Money and Private Sector Credit, 1980–2000
(In percent of GDP)

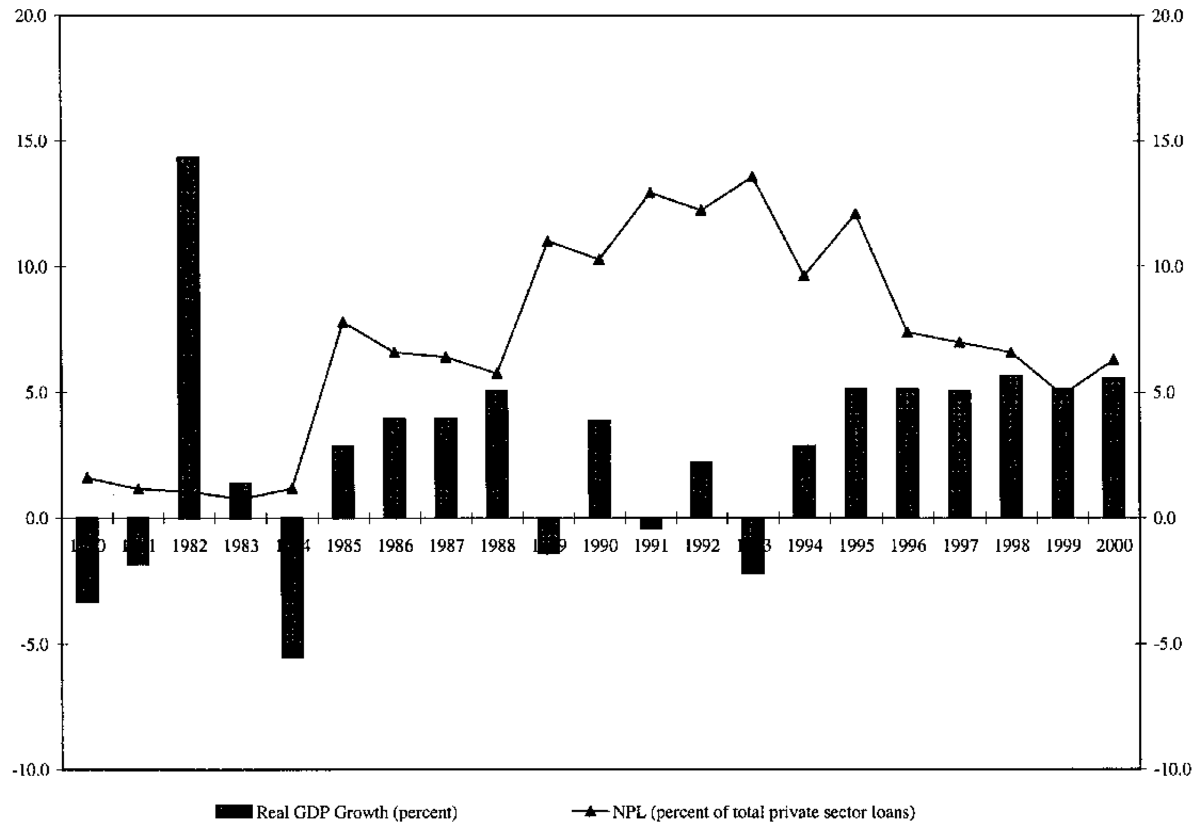


Sources: Senegalese authorities; and Fund staff estimates.

prices; and climatic conditions, which can significantly affect agricultural crops. Adding to these potential vulnerabilities are government-regulated producer prices for groundnuts and domestic energy prices, which at times are adjusted to changes in market prices with a lag. Since banks are actively engaged in providing financing to these sectors, these shocks and policies could have significant effects on the health of the financial sector through their impact on the credit risk of bank loan portfolios.

22. A simple illustration of the relationship between macroeconomic developments and the health of the financial sector is to compare movements in real GDP with the level of nonperforming loans in bank loan portfolios (Figure 3). The economic difficulties of the late 1980s/early 1990s undermined the credit quality of bank loan portfolios, triggering a tripling in the level of nonperforming loans as a share of total loans to the private sector. The need to provision against these loans eliminated bank profits in the late 1980s/early 1990s, and contributed to the failure of six banks. The nonperforming loans were consolidated by the BCEAO, and a specialized institution, the Societé Nationale de Récouvrement (SNR), which was established in 1991 to recover these loans. Despite this financial restructuring, the banking system remained weak prior to the January 1994 CFA franc devaluation, owing to loan repayment difficulties, low demand for credit, and a decline in bank deposits in anticipation of an exchange rate devaluation.

Figure 3. Senegal: Real GDP Growth and Nonperforming Loans, 1980–2000



Sources: Senegalese authorities; and Fund staff estimates.

23. Following the exchange rate adjustment, the economic situation became more robust, and the level of nonperforming loans gradually returned to pre-crisis levels. The banks experienced a surge in liquidity as a result of strong capital inflows, combined with initial weak demand for credit. After 1996, this excess liquidity diminished progressively as Senegal's economic recovery took hold and credit demand increased; meanwhile, the growth in deposits remained more moderate. The profitability of the banks consequently increased, and the banking environment became more attractive.

24. In late 2000, Senegal sought and received a rating by Standard & Poor's, the first country in the WAEMU to have ever done so. The sovereign rating of B+ for long-term loans places Senegal at a par with countries such as Brazil, Bulgaria, and Lebanon, which bodes well for the country's medium-term potential access to international capital markets. When announcing the rating, Standard & Poor's noted that the decision is supported by Senegal's membership in the WAEMU, and expectations that the government will continue to adhere to its program of structural reforms. The rating agency also noted that while the level of government debt in Senegal is well above the median for other countries in this rating category, the economic burden and liquidity risk associated with Senegal's debt is mitigated by the fact that almost all of it is external and concessional in nature.

III. Robustness of the Financial Sector

A. Banks

Banking system overview

25. The banking system in Senegal has gradually regained health and is generally well regulated and supervised, as indicated by the preliminary assessment of compliance with the Basel Core Principles. The Banking Commission and the BCEAO have addressed most of the problems that caused the banking crisis of the 1980s. However, the banks are still very vulnerable with respect to government pricing policies, external factors, and risk concentration.

26. The banking system is dominated by foreign banking groups, mainly French and one American. Although the French banks are majority-owned subsidiaries of their parents, the local Citibank operation is a branch of Citibank, N.A. Seven banks, accounting for almost 80 percent of the balance sheet of the banking system, are controlled by shareholders resident outside the WAEMU area. This means that the Senegalese banking system continues to depend largely on foreign interests. However, to the extent that these represent reputable international banking groups, the authorities consider this a source of strength for Senegal. Furthermore, the quality of the system is reinforced by the fact that the three Senegalese banks that are subsidiaries of French banks are more than 50 percent owned by their parent banks. Thus, their accounts are consolidated at the level of the parent institution.

27. The government's progressive divestment of its interests in the banking system is also noteworthy. The government's stake in each of the seven banks in which it has an interest is now less than 25 percent; majority control of the banking system is now in the hands of private interests, and the government is no longer involved in managing the day-to-day affairs of banks in which it has a stake. This compares favorably with the period prior to the bank restructuring when the government was the largest shareholder in seven banks and owned 35 percent of another, and often interfered with their day-to-day activities. Clearly, the role of the public authorities cannot be solely judged on the basis of their ownership interests in banks; however, the unanimous opinion of bankers in Senegal is that previously excessive government interference has been curtailed. Although the authorities may encourage lending in some strategic sectors, such as agriculture, the government has clearly ceased to exert pressure on certain types of lending, and no longer interferes in the internal management of institutions.

28. It should also be noted that the BCEAO continues to be a minority shareholder in two banks that specialize in agriculture and housing financing—although this represents less than 1.5 percent of the capital in the banking system. This is a holdover from the past when these banks needed stable sources of funds and the particularly sensitive sectors in which they were involved required strict management. Today, the BCEAO plays only an advisory role. Its intention to eventually divest its stakes in these two banks is welcomed.

29. The savings products offered by banks are term deposits (one month is reportedly the most popular term), savings accounts earning 3 percent, and noninterest-bearing sight deposits. There are no mutual funds or money market funds. Except for a specialized housing bank, which focuses on supplying real estate construction and mortgage financing for households, financing provided by the banks is generally for terms of up to 10 years, with variable interest rates that are tied to the banks' base lending rates.

30. Although complete data are not available, bank officials report that they obtain most of their funding from retail deposits (deposit liabilities represent 75 percent of the system's balance sheet). Sixty-eight percent of the deposit base consists of sight or notice deposits, which despite being redeemable on demand, tend to be a stable source of funds. With the exception of the housing bank, term deposits typically have maturities of one month, and here again the trend has been to regularly roll these over since the period of bank restructuring and currency devaluation. Those issued by the housing bank are non-redeemable and have maturities ranging up to four years. The remainder of the banking system's liabilities consists of: (i) bonds issued by banks to institutional investors to provide longer-term fixed-rate funding; (ii) interbank financing; and (iii) capital and reserves for doubtful loans.

31. Funds are primarily lent to Senegalese enterprises, of which four dominate the sector (SONACOS, SENELEC, SAR, and ICS). At April 30, 2001 total loans to the private sector stood at CFAF 683 billion (63 percent of total assets), of which CFAF 410 billion was short term (two years or less) and CFAF 222 billion medium and long term.[1] On a far smaller scale is the placement of funds in treasury and interbank instruments and in government guaranteed securities, most of which were issued during the period of bank restructuring.

32. The concentration of loans accorded to Senegal's largest enterprises was such as of April 30, 2001 that seven banks exceeded the prudential limit on risk concentration.[2] Credit to small and medium enterprises has been constrained, however, by the absence of credit assessment tools. Smaller borrowers do not tend to provide financial data about themselves, which leads to inadequate track records for most candidates. Moreover, the banks themselves have failed for the most part to establish adequate information technology that might otherwise enable them to classify accounts, generate reports, track loan performance, and generally perform the tasks inherent in reliable data management and risk management. As a result, they lack the capacity to lend effectively to a large number of smaller enterprises. There appears to be some hesitation in extending credit to small- and medium-sized enterprises whose viability is not clearly documented owing to incomplete accounting practices and financial disclosures. However, in the wake of difficulties with lending to SONACOS and SENELEC, some banks have begun expanding their branch networks this year in order to seek out lending opportunities among smaller borrowers as a means of diversifying their loan portfolios. The larger banks also have sizable holdings of government securities acquired during the bank restructuring period, which require no credit assessment capacity, yield 5 percent after tax, and can be used without penalty to secure temporary financing from the BCEAO, in addition to meeting reserve requirements.

33. Profitability in the banking sector was buoyant in the second half of the 1990s following the government sponsored program of bank restructuring in the late 1980s–early 1990s, and the currency devaluation in 1994 (which catalyzed economic activity) (Table 2). Banks owed their improved profitability to an interest margin that has exceeded 400 basis points since 1995.

---

[1] Loans of two years or less are viewed as short-term loans as per the reserve requirements on short-term loans.

[2] Under this regulation, the combined amount of loans representing more than 25 percent of a bank's capital cannot exceed eight times that of capital.

Banks' need to maintain interest margins at such levels is due primarily to high loan loss provisions, which net of recoveries have averaged 1.70 percent of total bank assets since 1995. Further integration into the WAEMU payment system may increase competition and narrow spreads, as may the future reduction of exposures to public enterprises. However, there is a risk of collusion in such a small and concentrated market.[3] The classification of loans and provisioning requirements appears to be adequate.

34. The comfortable interest margins enjoyed by all Senegalese banks, however, mask a number of trends that may potentially undermine profitability in the near future. Overhead costs may rise in the short run as information technology is introduced and strengthened and as some banks expand their branch networks. Although the level of nonperforming loans (NPL) is moderate, stricter provisioning for loan losses and the regulatory requirement to boost risk-adjusted capital levels to 8 percent by January 2002 may reduce that part of bank profits that might have been distributed as dividends. Clearly, on a sustained basis, both of these measures are expected to strengthen bank solvency. Profitability may also be constrained by the absence of opportunities for banks to diversify risk. Cross-border lending within the WAEMU region remains difficult.

35. Since 1996, the Senegalese banking system's capital base has been considerably strengthened, despite the extensive provisioning recorded in recent years. Bank capital rose from CFAF 27.8 billion in 1996 to CFAF 77.2 billion at April 30, 2001, though the number of institutions increased by only one. In April 2001, nine of ten banks had a risk-weighted capital ratio exceeding the 8 percent threshold set by the authorities. The one exception did not meet this condition because of sizeable additional provisioning and a change in the method of calculating its capital.

36. Given the rebuilding of the banking system's capital base, the stability of the Senegalese banking system in a prudential sense has improved somewhat in recent years. The number of violations of prudential regulations is limited, and those that remain mainly concern the concentration of credit risks and the transformation ratio.

37. With respect to the concentration of credit risks, banks are becoming increasingly exposed to the large parastatals, notably SONACOS and SENELEC, and also to petroleum companies operating in Senegal. As a result, the number of banks that do not adhere to the prudential limit on risk concentration has grown from five to seven between June 2000 and April 2001. The petroleum companies are having to borrow from the banks because SENELEC has been slow to pay them for purchases of petroleum. Although SONACOS is increasingly able to diversify their funding sources (borrowing directly from foreign banks offshore, and accessing capital markets for needed funds), this is a double-edged sword because it had to give these creditors priority claims on the proceeds from future sales of groundnut products. Such actions undermine the quality of the local banks' claims against SONACOS.

---

[3] The level of concentration in the Senegal banking sector is illustrated by the fact that the four largest banks account for almost 70 percent of deposits and loans. This is consistent with Herfindahl-Herschman Index data that suggests the level of concentration in Senegal in 1999 (0.15) was higher than in several other African countries—e.g., Ghana (0.13), Kenya (0.09 in 1997), and South Africa (0.14).

Table 2. Indicators of Banking Soudness in Senegal
(In percent)

CAMELS Indicators	1996	1997	1998	1999	2000
Capital Adequacy					
Total capital/risk-weighted assets (RWA) 1/					20.6
Total capital/ total assets	7.8	8.4	8.6	9.5	9.2
Assets					
Total loans/total assets	59.8	59.0	57.6	55.6	63.5
Loan concentration					
Five largest borrowers (gross) / total capital 2/	...	42.2	64.2	80.1	177.3
Sectoral distribution of bank credit					
Industrial (includes SONACOS)	21.0	20.2	22.2	29.6	31.3
Retail and wholesale trade	40.7	41.4	35.9	26.0	28.6
Services	11.5	12.6	14.3	16.4	14.9
Nonperforming loans					
NPLs (gross)/total loans	20.1	20.3	18.1	19.4	19.3
NPLs net of provisions/total loans	7.4	7.0	6.6	4.9	6.3
NPLs net of provisions/total capital	47.1	42.1	38.6	20.5	51.3
Management					
Noninterest expenses/revenues	54.9	46.0	40.9	43.3	44.8
Pre-tax earnings/employee (CFAF millions)	8.5	10.5	10.1	15.4	15.5
Earnings					
Pre-tax return/(average) assets	2.2	2.1	1.8	2.6	2.4
Pre-tax return/(average) equity	52.1	31.4	24.4	32.4	25.9
Interest margin/(average) assets	3.9	3.9	5.7	4.8	5.2
Noninterest expenses/(average) assets	3.3	2.9	3.3	3.0	3.2
Liquidity					
Liquid assets/total assets	33.3	34.1	35.7	35.9	28.4
Liquid assets/total deposits	38.9	39.5	41.8	44.4	34.9
Total deposits/ total liabilities	85.5	86.2	85.5	80.9	81.5
Sensitivity to market risk 3/					
Net non-Euro FX position / total capital	0.2	0.1	0.5	15.6	...
Net French franc FX position / total capital 4/	0.4	7.4	18.9	23.9	...

Source: Senegalese authorities.

1/ Risk-weighted capital adequacy calculations were introduced in 2000.
2/ Five largest borrowers include: SONACOS, SENELEC, SAR, ICS, and SODEFITEX.
3/ Sensitivity to interest rate risk not evaluated because with the exception of BHS, bank financial assets and liabilities are either tied to base lending rates or are repriced in one month or less.
4/ Net euro foreign exchange position beginning in 1998.

Credit risk and stress test

38. The banking system's exposure to SONACOS is a source of concern. As of April 30, 2001, total credit granted by the nine Senegalese-incorporated banks to SONACOS (i.e., all local banks except the one that is a branch of a large international bank) was the equivalent of 68.2 percent of these banks' capital, after deducting deposits provided by the Senegalese government to some of these banks to secure their loans.[4] All of these loans are

[4] The difference between current exposures (68.2 percent of locally incorporated bank capital) and the amount of capital impaired in the event of SONACOS' default (28.7 —Table 3) reflects
(continued)

classified on bank financial statements as performing loans. Since the 1999–2000 groundnut crop financing was not repaid on time, the outstanding crop credits were converted into normal loans at higher interest rates, as per the terms of the loan agreements. Nonetheless, some banks have classified these exposures for internal purposes as nonperforming as per their internal rating systems, and in view of the fact that the BCEAO had not renewed the SONACOS rating approval agreement.

39. Loans to SENELEC are also a cause for concern due to its unclear viability and the arrears it is accumulating with local petroleum suppliers. As of April 2001, loans to SENELEC equated to 20 percent of total bank capital for the locally incorporated banks. If the banks' exposures to SENELEC's local petroleum suppliers (notably the SAR petroleum refinery) are included, the equivalent in terms of locally incorporated bank capital rises to 69.2 percent.[5]

40. Given the uncertainties surrounding SONACOS and SENELEC, the mission assessed the banks' abilities to absorb losses in the event these two institutions fail to honor their obligations. Four scenarios were considered: (1) default by SONACOS on its current obligations after taking into account expected export receipts in 2001 from sales of groundnut products; (2) default by SENELEC on its current obligations; (3) default by SENELEC combined with defaults by the petroleum companies; and (4) combined default by SONACOS, SENELEC, and SENELEC's local petroleum suppliers. These can be considered hypothetical worst-case scenarios, which do not take into account the possibility that the Senegalese government might step in to cover the losses of its parastatals.[6]

41. Table 3 summarizes the results of the stress tests. If SONACOS is not able to honor its obligations and the banks have to fully provision their net exposures, four of nine locally incorporated banks would require significant injections of new capital from their parents in order to respect the Banking Commission's 8 percent risk-weighted capital adequacy guideline, although no bank's capital would be fully impaired. A default by SENELEC would require 6 of 9 locally incorporated banks to seek new capital, but would fully impair the capital of these 6 banks if a default by SENELEC undermined the financial stability of its petroleum suppliers. Thus, the stability of the local banks is highly dependent on the financial condition of SONACOS and SENELEC, and these companies' abilities to honor their financial obligations.

---

assumptions regarding the amount of loans that could be repaid from sales of groundnut products in 2001.

[5] However, it should be noted that as of April 30, 2001, SENELEC's difficulties had not yet resulted in a major increase in borrowing by the energy sector.

[6] Ideally, the staff would have also liked to conduct stress tests of the vulnerability of the financial system to movements in prices of groundnuts and other key commodities. However, there were insufficient data available to conduct such an analysis. Moreover, these tests would have been undermined by the government's involvement in setting producer prices for groundnuts and prices for energy consumed locally.

Table 3. Credit Risk Stress Test Results 1/

	SONACOS Default 2/	SENELEC Default	SENELEC and Petroleum Sector Default	All Three Sectors Default
Capital fully impaired (no. of banks)	0 (0)	0 (0)	4 (21.3)	6 (53.7)
Capital < 8 percent risk-weight (no. of banks)	4 (49.9)	6 (53.7)	6 (53.7)	6 (53.7)

Source: BCEAO.

1/Numbers in brackets indicate share of these banks' capital as a percent of total locally incorporated bank capital.

2/Simulations are based on April 30, 2001 data.

Market risk and stress test

42. The market risks faced by banks operating in Senegal are relatively minor and can be grouped in four categories: liquidity or transformation risk (risk of not being able to honor commitments or meet withdrawals because assets are less liquid than liabilities); exchange rate risk (risk of losses owing to exchange rate movements); interest rate risk (risk that the value of assets and liabilities might be affected differently by changes in interest rates); and other forms of market risk, such as the direct effects on the banks' of movements in equity and commodity prices.

Liquidity/transformation risk

43. Although some speculation about the possibility of a devaluation of the CFA franc at the time of the transition to the euro in 1998 did not result in a decline in the volume of bank deposits, there was a significant flight of capital away from the Senegalese banking system (as well as from other CFA franc-zone member countries) prior to the 1994 CFA franc devaluation. Total deposits in the Senegalese banking system declined 20 percent (CFAF 34 billion) and currency in circulation outside the banking system by 13 percent (CFAF 14 billion) in 1993, before rebounding sharply following the devaluation.

44. To assess the capacity of the banks to withstand such a crisis of confidence, an estimate was made regarding the percentage of deposits that could be withdrawn without causing problems for the institutions. For the system as a whole, banks' liquid assets and holdings of government securities cover 34 percent of deposit and interbank liabilities. Indeed, the liquidity ratio ensures that banks would have more than enough readily available assets to meet a run of deposits similar to the one that occurred in 1993. As a result, the banks should have ample liquidity to manage their structural transformation risk and absorb unexpected deposit outflows. However, as the interbank market continues to develop and becomes more integrated across the WAEMU, it would be reasonable to expect that the excess liquidity currently present in Senegal could eventually become more efficiently distributed across the union. Thus, the authorities will

need to ensure that the banks' liquidity management practices continue to develop so that they will be able to manage their transformation risk prudently and effectively in such an environment.

Foreign exchange risk

45. The net positions of three banks in euro-linked currencies have grown in recent years relative to their capital. However, there is currently virtually no risk related to a hypothetical adjustment of the parity. Total net positions in other currencies are also growing, but are fairly small and mainly found at one bank; hence, they too do not constitute a major risk factor for any of the banks under any plausible set of assumptions regarding future exchange rate movements. Thus, the risk associated with exchange rates for banks operating in Senegal is primarily credit risk-related in that exchange rate movements may alter the financial condition of local borrowers, and spill over to the banks in the form of higher loan losses. The mission was unable to obtain sufficient data to assess the magnitude and importance of this type of risk.

Interest rate risk

46. Banks do not appear to actively manage their exposure to interest rate risk on a continuous basis, and the prudential ratios used by the Banking Commission do not directly address the management of this type of risk. For most banks this is not a cause for concern. With the exception of the housing bank, their interest-bearing assets have very short-term or variable interest rates, and most of their interest-bearing liabilities are repriced in one month or less. Hence, movements in interest rates would not, in and of themselves, trigger material losses for these institutions.

47. Even though some of its loans are based on floating interest rates and a portion of its deposit base is long-term in nature, the housing bank, Banque de l'Habitat du Senegal (BHS), has a major structural exposure to interest rate risk in that it grants very long-term fixed-rate mortgages to households (the term is typically the number of years before the borrower retires and thus can range up to 20 years), which are funded by floating-rate deposits and term deposits with maturities ranging up to four years. Officials at this bank appear to be fully conscious of the risks associated with such a mismatch, and have endeavored to extend the duration of their liabilities, for example by privately placing 5–7 year bonds with institutional investors. However, the embryonic state of capital markets in the WAEMU prevents them from being able to issue the long-term liabilities needed to fully eliminate this mismatch. This institution is highly underlevered, with a capital adequacy ratio in excess of 40 percent on a risk-weighted basis; thus, it should be able to cope with the direct effects of a major interest rate shock and still respect the Banking Commission's minimum capital adequacy ratio under any plausible interest rate scenario. In the future, the bank should consider changing the terms and conditions of future mortgage loans granted so that they can be repriced more frequently in line with its liabilities.

Other market risks

48. The banks do not have any material equity price risk, inasmuch as equity markets are at a nascent stage of development in the WAEMU region. Regarding commodity price risk, there is no information on the direct exposure of banks and other credit-granting institutions. However, exports and imports of a few commodities continue to play a significant role in the Senegalese economy suggesting bank clients are exposed to these price swings even if the banks are not.

Thus, for the banks exposure to commodity price risk—through its links to the credit risk of borrowers—is high, albeit probably less than would be the case for some other members of the WAEMU, since Senegal has a relatively well-developed service sector. It is worth noting that the collapse of commodity prices on world markets in the latter half of the 1980s contributed to some extent to the Senegalese banking crisis in the late 1980s to early 1990s.

B. Insurance Companies

49. The Senegalese insurance industry represents less than 10 percent of total financial system assets, and thus does not constitute a major source of systemic risk to the rest of the financial system. However, it does display several signs of vulnerability. The Senegalese insurance industry is stagnant, rather protected, with a large number of companies retaining too much risk, and engaging in poor diversification. Consolidation in the sector should be promoted and regulation amended to allow diversification of risk in foreign markets.

50. The major strength of the Senegalese insurance industry is represented by the CIMA (Conférence Interafricaine des Marchés Publics d'Assurance) code and the availability of financial information on individual companies. The Commission Régionale de Contrôle d'Assurance (CRCA) supervises the insurance industry for the region as a whole. Nonetheless, it relies on national Direction Nationale des Assurances (DNAs), located in the ministry of finance in Senegal's case, to conduct day-to-day supervision of insurance companies within each country. In Senegal, the DNA has hired five well-qualified staff members, but there are no actuaries, which limits the support it can provide to the CRCA. Hence, there is a need to ensure that services provided by the CRCA and the DNA in Senegal are coordinated, and that resources are used effectively.

51. The minimum capital requirement for insurance companies in the region is low. As a result, there have been a large number of applicants. The minimum capital requirement was recently increased to CFAF 500 million (CFAF 300 million for mutual companies), a figure the mission believes should be gradually increased to CFAF 1 billion (CFAF 600 million for mutual companies). However, this would have almost no impact on the companies in Senegal that own funds well above these values.

52. Principles of corporate governance and internal controls are not applied in Senegal. The mission recommended that Board of Directors be required to set investment policies and policies on conflicts of interest, and to establish formal internal controls that the supervisor should monitor.

53. The high retention of risk in Senegal originates from different causes. The maximum reinsurance rate of 50 percent allowed in the calculation of the solvency margin is the same as the one used in the European Union. However, it appears too low for the Senegalese market and it could lead to excessive risk retention. The mission recommends that it be increased to 70 percent provided regulations are in place to encourage reinsurance with reinsurers that are financially strong.

54. The limited use of reinsurance in Senegal raises concerns for the solvency of the industry. Especially because current reinsurers are not monitored and reserves cannot be diversified abroad because existing arrangements surrounding the convertibility of the CFA franc preclude investing offshore. Consequently, reserves should be allowed to be freely invested in the region

and, if possible, outside the region. Also, the CIMA Code does not foresee overall and/or individual risk exposure limits. Most countries impose retention limits similar to those held in addition to whatever capital adequacy regime they have. A widely used standard is to limit the maximum a company will retain on a single risk to 10 percent of its own funds.

C. Microfinance

55. Microfinance development in Senegal has kept pace with the dynamic evolution of the subsector in the WAEMU. In Senegal, the number of institutions (institutions de base) and their membership have reportedly grown to reach about 18 percent of the households, almost three times the 1995 coverage rate, and clearly higher than that of other countries in the continent. Deposit balances in MFIs have grown about five times as fast as those held in the banking system in recent years, thus increasing the relative importance of MFI deposits vis à vis bank deposits from the equivalent of 1 percent in 1996 to 2.4 percent as of June 2000.

56. While three types of MFIs coexist, the mutualiste savings and credit model largely dominates the market. Four of these institutions, out of about 30 included in the BCEAO-BIT data bank, account for more than 80 percent of the total membership. These larger institutions, with one exception, are organized as networks (réseaux) with well-established information systems, regular internal controls, and adequate liquidity management arrangements with commercial banks. Their recovery rates are reportedly above 95 percent, although their overall soundness is difficult to evaluate since key performance indicators are undisclosed.

57. Aside from the major MFIs, a large number of small entities are authorized to mobilize savings and make loans with small membership and weak institutional structures. Indeed, the rapid expansion of the sector and the apparent lag in establishing adequate monitoring mechanisms create two main sources of concern. First, the risk of excessive proliferation of weak institutions and subsequent failures involving the loss of savings for low-income households, and the impact these failures may have on the overall image of the MFI sector. Second, at the other end of the spectrum, is the concern voiced by the large institutions about the options available to consolidate and solidify their structures without necessarily becoming a bank.

Supervision capacity, a key constraint

58. The Assistance Technique aux Caisses Populaires d'Epqargne et de Crédit (AT/CPEC) unit at the Ministry of Economy and Finance is responsible for the supervision of MFIs. While a strict regulatory framework is not appropriate for MFIs, with a total of 12 employees, the unit's capacity to oversee close to 500 institutions appears inadequate.

59. Two recommendations were made: (a) strengthening the unit's capacity and providing a close monitoring of the licensing of new MFIs; and (b) evaluating the need to establish an appropriate supervisory body for MFIs. Concerted action among all the interested parties will be necessary.

Interest rate ceiling

60. While the interest rate ceiling of 27 percent, in practice, is not enforced, it encourages circumvention by the MFIs so as to help cover their operating costs, typically much higher than the margins implicit in the usury rate, particularly for small-scale MFIs.

D. Securities Markets

61. Securities market trading in the WAEMU takes places on a regional basis. Equities are traded in Abidjan at the Bourse Régionale des Valeurs Mobilières (BRVM), which was legally established in December 1996, and began operation in September 1998. The WAEMU securities market is therefore in its early phase of development.

62. Securities market trading in the WAEMU is quite limited. At end-December 2000, there were 41 shares listed at the exchange. Thirty-five of these were carried over from the former Abidjan stock exchange. The remaining six new shares correspond to public offerings made since the BRVM was created. Of these, four are from Cote d'Ivoire, one from Senegal, and one from Benin.

63. The bond market, however, has become increasingly active since the inception of the regional market. The total value of listed bonds has spiraled from CFAF 40 billion in September 1998 to CFAF 129 billion at the end of 2000. Currently, there are 17 bond issues listed, from 13 different issuers. These issuers range from national governments (which typically sell treasury bonds), to quasi-public regional development banks, to privately owned commercial banks and industrial companies.

64. The securities market faces several problems, including the weak observance of IOSCO principles (Section II). These weaknesses are the consequence of being a recently established market. The first issue affecting this market is its financial viability and sustainability. Since it is a relatively new component of the financial system, the securities market has not reached the volume of activity needed to cover its operating costs, including those of the supervisory system. Nor is the volume sufficient to enable the market intermediaries and the two central institutions (exchange and depository) to break even. In addition, owing to this low level of activity, intermediation costs are high, which further limit the market's liquidity. The regional body responsible for the regulation of this market (Conseil Regional) set regulations that are broadly in line with international practice. However, there are substantial deficiencies with respect to adequate resources and the capacity to perform its functions and powers. Also, the practical implementation of the ongoing supervision of the SROs is lacking and the Conseil has not yet established the full mechanism of supervision.

E. Pension System

65. The pension system in Senegal does not cause serious concerns of systemic risk to the rest of the financial sector. The reason being that very few links exist between the retirement schemes and the rest of the financial sector. FNR (Fonds National de Retraite) has no reserves, while IPRES (Institution de Prévoyance Retraite du Sénégal) had CFAF 35 billion in reserves in 2000, which represent only 5 percent of total financial assets (here approximated by M2) in the economy. These reserves are almost entirely placed in the banks and are expected to slowly decline, reflecting the changes in the demographic structure of the population covered. For

instance, a recent actuarial report by IPRES estimates that reserves will be reduced to zero by 2006/2007.

66. The current financial situation of the pension system may have an important fiscal impact in the future because of the explicit (in case of FNR) and implicit (in case of IPRES) government guarantees linked to the public nature of the service provided by these schemes. It is recommended that urgent parametric reforms be implemented to the FNR and IPRES plan to temporarily postpone the insolvency of these schemes. These reforms should give enough time to the Government to study a systemic pension reform aimed at funding pension liabilities.

IV. Infrastructure Supporting the Financial System

A. Legal System

67. Judicial organization in Senegal is governed by Decree 84–1194 of October 22, 1984 organizing the Judiciary. There are no commercial courts or sections specializing in commercial law in the tribunals and courts.

68. As for the enforcement of decisions, creditors who are not paid by their debtors may obtain the forced execution of instruments and judgments recognizing the existence of their rights. It seems, indeed, that numerous debtors demonstrate ill will with respect to paying their bank debts. However, forced execution is not an ideal system for creditors, as they are required to observe the rules of judicial enforcement if they do not wish to have their action declared null and void.

69. The functioning of justice in Senegal has traditionally been recognized as satisfactory. However, certain current trends are beginning to be worrisome. Although the Single Act on Simplified Procedures of Collection and Enforcement Means entered into force in the member states in 1998, and the associated simplified procedure should have been advantageous to creditors, in reality many Senegalese debtors seem to have systematically used certain channels of appeal associated with the sophisticated civil procedures law as delaying tactics, with a view to prolonging the procedures in a way that can be considered excessive. Such tactics can impede the ability of banks and other lenders to expeditiously foreclose on their collateral, which adds to the amount of credit risk in the financial system.

70. The modernization of the Senegalese justice has not followed the same pace of development as the financial system, and exhibits certain sluggishness. In addition, judicial infrastructures are extremely outmoded: there is little or no computer or consultative hardware, and most legal decisions are not systematically published. There are also real problems of availability, access, security, and safekeeping of the documentation that is supposed to be kept by the judicial system.

71. The functioning of justice is often criticized these days by the financial community, in particular certain banks, which express doubts about the competency of magistrates and the quality of their decisions. It seems that the capacity has not yet been developed to provide magistrates with continuing training in banking and financial law. To deal with this problem, a higher school for magistrates was recently established by the Organisation pour l'Harmonisation en Afrique du Droit des Affaires (OHADA). One of the expectations is that it will provide

magistrates with training in financial law. Currently, magistrates are not necessarily assigned on the basis of their specialization, something that will probably change with the availability of magistrates trained in banking and finance. Given the disadvantage of marring the image of a judicial system that has been generally deemed to be satisfactory on other points, measures should be taken to strengthen its credibility in the financial area. These include:

a. Consider the possibility of creating commercial courts or making courts specialized by creating commercial chambers with specialized magistrates.

b. Promote the use of arbitration and mediation in the banking sector, so as to limit lawsuits.

c. Intensify training for judges and court clerks in the area of commercial, banking, and financial law. Arrange to have judges assisted by clerks or junior court officers to facilitate their work.

d. Make arrangements to improve the infrastructures and resources of the courts and tribunals, as well as their maintenance (computerization, documentation, furniture, hearing rooms, office equipment, regular and timely publication and dissemination of legal decisions).

72. The Council of the Senegalese Bar has also requested banks to be more transparent regarding credit terms, in particular when the customer is not very educated or is unfamiliar with the banking system.

B. Liquidity Management and Interbank Market

73. Banking system liquidity management and, more generally, monetary policy are conducted on a regional basis by the BCEAO. As indicated in the Transparency Code assessment (Section II), the BCEAO largely observes the main principles. The pegged exchange rate arrangement limits monetary policy flexibility. However, given that international capital flows are limited, there is some scope for pursuing an independent monetary policy, aimed at maintaining inflation on par with that prevailing in the European Monetary Union. To this end, the BCEAO influences the evolution of total liquidity circulating in the region mainly with the help of two monetary instruments: reserve requirements and standing facilities, and on occasion with some open market operations. In addition, the BCEAO charter specifies that central bank advances to Governments must not exceed 20 percent of the previous year's fiscal revenue. At end-1998, the WAEMU Council of Ministers decided to freeze the cap on those advances at the level reached in December 1998 and to take steps to eliminate them by end-2001. Beginning in 2002, government securities with maturities between seven days and two years will be issued to finance government requirements.

74. Since its inception, the BCEAO has generally met its monetary objectives, and no liquidity crises have arisen. In the early 1990s, the BCEAO's intervention instruments were modified and adapted as part of the move from direct to indirect monetary management, and an interbank money market was introduced. Notwithstanding the success of the monetary union, there is little regional interbank market activity. Studies are under way to fully develop the region's capital markets and foster interbank market activities.

75. Reserve requirement is the instrument used, at times, at the initiative of the BCEAO to manage a country's liquidity. Reserve requirements differ across BCEAO countries. In Senegal, the reserve ratio was raised from 3 percent to 9 percent in August 2000. The ability to set different reserve ratios in the various WAEMU member states without triggering intra-regional flows of deposits or loans, is evidence that monetary integration in the Union remains limited. Another feature of the WAEMU reserve requirements system is that assessments are made on both the short-term liabilities and short-term assets of banking institutions. Reserve requirements on short-term loans are used by the BCEAO to control the growth of these loans compared to other assets and to facilitate the transition from the old system of credit controls to the current one based on market forces.[7]

76. Following the introduction of government securities by member countries in 2002, the authorities should consider using open market operations more frequently to adjust domestic liquidity in Senegal. To the extent that the transition to indirect instruments has been successful and within the framework of increased development of the money market, reserve requirements should be eliminated with respect to assets and maintained only against deposits once that active open market operations are introduced to manage banks' liquidity. The announced close cooperation between the BCEAO and the Ministry of Finance in the area of debt issuance was welcomed and strongly supported. The recently approved IMF/World Bank Guidelines for Public Debt Management should assist the authorities in this area.

Interbank market

77. Although the relevant framework and procedures are in place, the interbank market is not very developed, in particular for transactions across member states of the Union. With the introduction of government securities in 2002, the BCEAO was strongly encouraged to continue its efforts to foster the development of a collateralized regional interbank market. This should facilitate capital flows within the monetary union and correct the liquidity disparity between member countries. This would also help the authorities to apply reserve requirements at the same rate for all countries.

C. Payment System

78. Senegal's payment system is at an early stage of development and fails to meet the needs of a modern economy and an active interbank market. The chief weaknesses have been clearly identified by the BCEAO for the Union as a whole and for each member country. The BCEAO has launched a reform of payment systems at the regional level, with financial and technical assistance from the World Bank, which should result in the implementation of a system consistent with recommended international standards for risk and efficiency. Inter alia, the legal

[7] The authorities indicated that this reserve requirement is an effective instrument to limit credit expansion in Senegal. The disadvantage of such a requirement is that it slows the effect of a decline in deposits (and thus of a downturn in business) on the banking system, and thereby eventually creates some difficulties. One is that banks cannot rapidly adjust their lending, not even their short-term loans, and are required to continue constituting reserves even when their resources have dwindled. In normal situations, it also discourages credit expansion to the private sector.

framework needs to be strengthened—particularly with regards to modernizing payment instruments and the underlying rules and procedures governing settlement. However, the current manual system does not present any systemic risks, since BCEAO staff closely monitor its operations at the source when large transactions and transfers are undertaken among participants of system and with other WAEMU countries or foreign countries.

79. The current payment system is slow and inefficient. As a result, most monetary transactions are conducted using cash, since less than 9 percent of the Senegalese working population has a bank account (compared to 18 percent who are members of MFIs). Exchanges of securities within clearing houses are handled manually, and checks and payment items are physically exchanged on-site at local and national clearing agencies. Delays in crediting customers' current accounts (following clearing) stand at three days locally, but may exceed two weeks when the clearing process takes place in a financial center apart from the one in which the payment was initiated.

80. The inefficiency of the current payment system is one of the reasons why the WAEMU interbank market is very thin, and helps to explain why banks refinance a significant portion of their funding requirements through the BCEAO by mobilizing their holdings of government securities or private securities authorized by the BCEAO.

Reform of the payment system

81. With a view to correcting the weaknesses mentioned above, the BCEAO, with financial and technical assistance from the World Bank, has launched a project to reform the payment system of the members of the Union, including Senegal's. Preliminary studies were completed in 1999 and 2000; World Bank funding was provided to the BCEAO in October 2000; and invitations to bid for the provision of interbank clearing and settlement systems are currently being prepared. The project, which is expected to be completed in 2002, is expected to provide the Union with a modern payment system permitting: (1) a real-time gross settlement for large transaction; (2) automated settlement through the creation of national clearing houses, and electronic settlement systems for low-value transactions; (3) a shift from paper-based clearings to rapid electronic settlement; (4) the assurance of rapid finality of settlement for securities transactions; and (5) the development of transactions using bank cards via interbank networks and acceptance of a common product. There is every expectation that the new payment system will conform to international standards.

SECTION II—FINANCIAL SECTOR ROSC MODULES

This section contains information on adherence to and consistency with major international standards and codes relevant for the financial sector. The assessment has helped to identify the extent to which the supervisory and regulatory framework has been adequate to address the potential risks in the financial system. It has also provided a source of good practices in financial regulation and supervision in various areas.

Detailed assessments of standards were undertaken based on a peer review process, as part of the Financial Sector Assessment Program (FSAP), by Luc Cardinal (World Bank) and Marcel Maes (Consultant, Belgium Commission Bancaire et Financiere (retired) for the preliminary assessment of the *Basel Core Principles for Effective Banking Supervision*; Andres Jaime (World Bank) and Brian Gelfand (IOSCO) for the *International Organization of Securities Commissions' Objectives and Principles of Securities Regulations*; and Christine Sampic (IMF) for the IMF's *Code of Good Practices on Transparency in Monetary and Financial Policies*. The expert team prepared detailed assessments by drawing on information provided by the Senegalese authorities, including self-assessments, and on fieldwork during November 2000 and January 2001. This section contains a summarized version of the assessments included in the FSAP report.

Since Senegal is a member of the WAEMU region, monetary policy and financial sector supervision are conducted for the region as a whole by regional institutions. Therefore, the assessments made in the context of Senegal apply for the region as a whole.

The assessments confirm that notable, albeit uneven, progress has been made by the WAEMU in introducing international standards. According to a preliminary assessment, considerable progress has been made by the Banking Commission to comply with most of the Basel Core Principles for Effective Banking Supervision and efforts are under way to achieve full compliance, in particular in the money laundering area. However, several weaknesses were identified (Appendix I). The shortcomings in the observance of several IOSCO principles indicate weakness in the area of secondary market supervision, prudential regulations and intermediation, risk management and exchange of information (or coordination with other regulators). Overall, there will be a need in the future for some coordination among all the regional supervisory bodies. The payment system is undergoing reform, thus no assessment was made, since a new payment system, which should observe most of the CPSS Core Principles, is expected to be introduced in 2002. Finally, transparency practices relating to monetary policy with reference to the IMF Code of Good Practices on Transparency in Monetary Policies is satisfactory.

V. Compliance with the Basel Core Principles for Effective Banking Supervision

82. A preliminary assessment was made during this mission and some of the main findings are summarized in Appendix I. A final assessment is expected to be made in the context of the forthcoming FSAP mission to Côte d'Ivoire.

VI. Observance of IAIS Insurance Supervisory Principles

83. An initial assessment for the region as a whole was made in the context of the Cameroon FSAP, and the assessment is contained in the Board paper FO/Dis/00/66. An update of the assessment is being conducted in the context of the FSAP mission to Gabon.

VII. Observance of IOSCO Objectives and Principles of Securities Regulation

General

84. This assessment covers the WAEMU securities sector, for which regulation and supervision are largely the responsibility of the Conseil Régional de l'Epargne Publique et des Marchés Financiers (CREPMF). The main objectives of the assessment are to determine levels of observance with the International Organization of Securities Commissions (IOSCO) Objectives and Principles of Securities Regulation, and to suggest areas where further development may be appropriate. The assessment of securities regulation for the WAEMU market was performed in January/February 2001 as part of the FSAP assessment for Senegal, but its findings apply to the region as a whole.

85. The assessment is based on a review of the WAEMU securities laws and regulations, the CREPMF Annual Report, market information from the stock exchange and other market intermediaries, and extensive discussions with the staff of the CREMPF. In addition, meetings with the stock exchange, the central depository/clearing and settlement bank, market intermediaries, issuers and investors also provided valuable input to the assessment.

Institutional and macroprudential setting, market structure—Overview

Supervisory framework

86. The regulator of securities markets in the WAEMU is the Conseil Régional de l'Epargne Publique et des Marchés Financiers ("Conseil Régional," or "Conseil") created by the Convention Portant Création du Conseil Régional de L'Epargne Publique et des Marchés Financiers, an agreement among the member States of the WAEMU. The composition, organization, functions and powers of the Conseil Régional are set forth in the Annexe Portant Composition, Organisation, Fonctionnement et Attributions du Conseil Régional de L'Epargne Publique et des Marchés Financiers (the "Annexe"). The Conseil des Ministres of the WAEMU has adopted, and has the power to modify Regulations to specify the practical implementation of the powers of the Conseil Régional ("the Regulations").

87. The Conseil Régional is charged with the responsibility to organize and supervise public offerings of both debt and equity securities, and to authorize and supervise market structures (bourses and clearing and settlement systems) and market intermediaries. The Conseil des Ministres can modify the Regulations, and the Conseil Régional can interpret the Regulations through the publication of Instructions.

88. The CREPMF is the central regulatory body of the securities market. It has the mandate of protecting investors in securities and any other similar instrument marketed through a public offering in the countries that are part of WAEMU. To accomplish this objective, it is the institution designated to regulate and authorize, through the issuance of a visa, the processes of public offerings of securities, irrespective of whether the securities are listed in an exchange or not; and to license and control all market structures and intermediaries.

Market structure

89. The regional stock exchange (BVRM) in Abidjan is the main component of the WAEMU capital market and handles trading in equity and debt securities in the region. The market is supported by the regional depository, the Dépositaire Central/Banque de Règlement (DC/BR). Over-the-counter trading of securities does not take place. There are 15 broker-dealers, most of which are subsidiaries of banks. SGPs (investment counselors) and investment promotors also operate in the market.

General preconditions for effective securities regulation

90. The three core objectives of securities regulation are the protection of investors; ensuring that markets are fair, efficient and transparent; and the reduction of systemic risk.

91. These objectives are closely related and, in some respects, overlap. Many of the requirements that help to ensure fair, efficient, and transparent markets also provide investor protection and help to reduce systemic risk. Similarly, many of the measures that reduce systemic risk provide protection for investors.

92. Further, matters such as thorough surveillance and compliance programs, effective enforcement and close cooperation with other regulators are necessary to give effect to all three objectives.

Main findings

93. The responsibilities of the regulator, as well as procedures for appointment, terms of office and removal of members of the governing body of the regulator are clearly specified in the Regulations. These regulations also provide for protection of regulators and their staff acting in the bona fide discharge of their functions and powers. However, they do not provide for strong cooperation among domestic regulatory authorities, and apparently there is little formal communication or cooperation between the Conseil Régional and other relevant regulatory authorities, such as the regulator of the banking sector in the WAEMU. The only form of public accountability of the Conseil is the requirement to publish an annual report. Decisions of the

Conseil are not published and there is no requirement in the law or regulations that decisions be supported by written reasons.

94. The Conseil is granted wide powers for the authorization and supervision of market structures and market intermediaries, and the authorization and supervision of public offerings of debt and equity instruments. The extent of these powers seem to be adequate. However, there appear to be substantial deficiencies with respect to adequate resources and the capacity to perform its functions and exercise its powers.

95. In terms of transparency, there is no provision, or requirement, for the Council of Ministers to consult with the public in making or modifying the Regulations. Also, there are no provisions, or requirements, for consultation when the Conseil prepares Instructions, but the Secretariat does consult with the exchange and market intermediaries on an informal basis.

96. The Regulations provide that the Conseil Régional supervises the activity of the SROs. The statutory and regulatory requirements implement the relevant IOSCO Principles. However, the practical implementation of the ongoing supervision of the SROs is lacking. The Conseil has not yet established the mechanisms to supervise the Bourse and the DC/BR, or their operations.

97. The Conseil is granted wide powers to inspect, investigate and conduct surveillance of market activities. The Conseil also controls the activity of all market participants. Although the Conseil has sufficient powers of inspection, investigation, and surveillance, it is not equipped with sufficient resources and expertise to fully implement these powers. Perhaps the most glaring absence is the lack of market surveillance to detect unfair practices, market manipulation, or insider trading.

98. The Conseil can also verify issuers' respect of their obligations in a public offer. It is empowered to conduct both off-site and on-site supervision of authorized market intermediaries, but neither the Bourse nor the DC/BR have yet been inspected; nor is there any framework for their inspection. No investigations of market participants have been conducted either.

99. The Conseil has joined IOSCO and has signed two technical cooperation agreements, but to our knowledge, no information sharing or enforcement agreements have been established with any domestic or foreign counterparts.

100. The Conseil has the authority to authorize and supervise collective investment schemes (Organismes de Placement Collectif en Valeurs Mobilières, or "OPCVMs"). The main areas that remain to be implemented are: rules and procedures for ongoing supervision, prudential rules, and the addition of some provisions addressing potential conflicts of interest between the interests of investors in the scheme and those of scheme operators or their associates.

101. There are clear minimum standards for the authorization of market intermediaries, with requirements varying according to their activities. However, there is no general "fit and proper" requirement.

102. Market intermediaries are required to meet initial and ongoing capital requirements. These are set at a flat rate, and do not reflect any underlying risk. The regulations indicate that prudential rules setting out solvency and liquidity requirements will be issued in an Instruction.

There are currently no prudential requirements for market intermediaries and, therefore, capital requirements do not reflect the risks of the business, off balance sheet transactions, or activities of affiliated companies. The General Secretariat has indicated that these rules are in preparation.

103. The Conseil is given exclusive authority to authorize and supervise market structures, notably the Bourse and the DC/BR. However, the Conseil has no real-time access to market information, and does not review trading logs, although the General Secretariat stated that this will be implemented shortly. The Bourse conducts surveillance of trading, mainly to ensure orderly trading and the respect for its own rules. There is no organized, methodical detection and control of market manipulation, insider trading, or other unfair market practices. In summary, while the Regulations authorize the Conseil to supervise the operations of the market, and the Instructions require the Conseil to have real time access to all market information, no actual oversight takes place.

104. Finally, in terms of systems for clearing and settlement of securities transactions, the DC/BR has implemented procedures that appear to be designed to ensure that they are fair, effective and efficient and that they reduce systemic risk. However, there is little supervision of the operation of the DC/BR. The DC/BR files an annual report with the Conseil, and provides a quarterly report of the balance in the Guarantee Fund. The Conseil does not monitor the clearing and settlement system, nor has it carried out an inspection of it. Table 4 summarizes the observance with the principles of securities regulation.

Table 4. Summary of Main Findings of Assessment of Implementation of the IOSCO Objectives and Principles of Securities Regulation

Subject	Main Findings
Principles relating to the regulator, (CPs 1–5)	The responsibilities of the regulator, as well as procedures for appointment, terms of office and removal of members of the governing body of the regulator are clearly specified in the Regulations. These regulations also provide for protection of regulators and their staff acting in the bona fide discharge of their functions and powers. However, they do not provide for strong cooperation among domestic regulatory authorities, and apparently there is little formal communication or cooperation between the Conseil Regional and other relevant regulatory authorities, such as the regulator of the banking sector in the WAEMU. The Regulations provide for the independence of the Conseil from external, political or commercial interference in the exercise of its powers. There is also an instance of judicial review of the decisions of the regulator. However, the only form of public accountability of the Conseil is the requirement to publish an annual report. Decisions of the Conseil are not published, and there is no requirement in the law or regulations that decisions be supported by written reasons. The Conseil is granted wide powers for the authorization and supervision of market structures and market intermediaries, and the authorization and supervision of public offerings of debt and equity instruments. The extent of these powers seems to be adequate. However, there appear to be substantial deficiencies with respect to adequate resources and the capacity to perform its functions and exercise its powers.
Principles of self-regulation (CPs 6–7)	The statutory and regulatory requirements implement the relevant IOSCO Principles. However, the practical implementation of the ongoing supervision of the SROs is lacking. The Conseil has not yet established the mechanisms to supervise the Bourse and the DC/BR, or their operations.

Subject	Main Findings
Principles for the enforcement of securities regulation (CPs 8–10)	The Conseil is granted wide powers to inspect, investigate and conduct surveillance of market activities. It can also verify issuers' respect of their obligations in a public offering. The Conseil is empowered to conduct both off-site and on-site supervision of authorized market intermediaries. Although the Regulations grant it sufficient powers of inspection, investigation, and surveillance, the Conseil is not equipped with sufficient resources and expertise to fully implement these powers, and the Bourse only engages in very limited market surveillance.
Principles for cooperation in regulation (CPs 11-13)	The Regulations permit the conclusion of reciprocal information sharing and cooperation agreements with foreign financial market regulators. However, this is not the case for domestic regulators, for example, banking or insurance supervisors. This is of particular concern because of the significant number of market intermediaries that are subsidiaries of banks.
Principles for issuers (CPs 14–16)	The framework of securities regulation requires disclosure of financial results and other information on both an initial and ongoing basis. Basic protection measures are in place for minority shareholders. Some further measures, such as dissenter's rights of appraisal, mandatory cash buyouts, and rights of the minority shareholders to appoint an auditor, would improve protection of minority shareholders.
Principles for collective investment schemes (CPs 17–20)	The regulatory framework sets out clear requirements for the authorization of collective investment schemes. The main areas that remain to be implemented are: rules and procedures for ongoing supervision, prudential rules, and the addition of some provisions addressing potential conflicts of interest between the interests of investors in the scheme and those of scheme operators or their associates.
Principles for market intermediaries (CPs 21–24)	There are clear minimum standards for the authorization of market intermediaries, with requirements varying according to their activities. One area in which implementation could be strengthened is that of the qualification of staff. There are currently no courses or examinations for the licensing of staff. Market intermediaries are required to meet initial and ongoing capital requirements. These are set at a flat rate, and do not reflect any underlying risk. There are currently no prudential requirements for market intermediaries and, therefore, capital requirements do not reflect the risks of the business, off-balance sheet transactions, or activities of affiliated companies. The General Secretariat has indicated that these rules are in preparation.
Principles for the secondary market (CPs 25–30)	The Conseil is given exclusive authority to authorize and supervise market structures, notably the Bourse and the DC/BR. General criteria for the authorization of the Bourse and the DC/BR are contained in the Regulations, while Instructions stipulate the specific relevant provisions. There is no organized, methodical detection, and control of market manipulation, insider trading, or other unfair market practices. In summary, while the Regulations authorize the Conseil to supervise the operations of the market, and the Instructions require the Conseil to have real time access to all market information, no actual oversight takes place. In terms of systems for clearing and settlement of securities transactions, the DC/BR has implemented procedures that appear to be designed to ensure that they are fair, effective, and efficient and that they reduce systemic risk.

Recommended next steps and authorities' response

105. The substantial deficiencies with respect to adequate resoures and the capacity to perform functions and exercise powers could be addressed by further delegating powers from the Conseil Regional to either a full-time president, or alternatively, to the Secretary General. Also, since

neither the Conseil nor the Secretariat staff appears to have sufficient knowledge of or experience in securities markets, experts should be recruited and further training provided to Secretariat staff.

106. The Conseil needs to introduce mechanisms to supervise the Bourse, the DC/BR, and their operations. The BVRM should introduce market surveillance to detect unfair practices, market manipulation, and insider trading.

107. The securities industry should introduce reciprocal information sharing agreements with the regional banking and insurance supervisors, given the number of market intermediaries that are subsidiaries of banks.

108. Further measures to protect minority shareholders could be introduced, including: dissenter's right of appraisal, mandating cash buyouts, rights of minority shareholders to appoint an auditor, derivative actions, and rights of shareholders to require an extraordinary general meeting of shareholders.

109. Staff qualification requirements for market intermediaries could be introduced, such as courses or examinations for the licensing of staff. In addition, the authorities' intention to prepare rules governing the prudential standing of market intermediaries were welcomed.

110. The Conseil's supervisory capacity would benefit from having real-time access to market information and systems to analyze trading logs. In addition, the Conseil should monitor further the performance of the clearing and settlement system.

111. The assessment was presented to the authorities, but they have not provided any comments.

VIII. Observance of the Code of Good Practices on Transparency in Monetary and Financial Policies

General

112. This assessment is based on: (i) discussions with various departments of the BCEAO; (ii) a review of questionnaires on the IMF Code of Good Practices on Transparency in Monetary and Financial Policies (MFP) submitted by the BCEAO; (iii) a review of the main laws and regulations governing the BCEAO's activities; and (iv) a review of the BCEAO's internet website and its regular publications. In addition, discussions were held with other financial sector participants including officials and staff of commercial banks. This assessment was made in the context of the FSAP mission to Senegal, but its findings apply to all BCEAO countries, since the BCEAO operates on a regional basis.[8]

[8] The assessment was only prepared for the conduct of monetary policy.

Legal framework, institutions, and market structure—Overview

113. The objectives and the institutional framework of monetary policy are clearly defined in the Treaty establishing the WAMU, signed on May 12, 1962, and revised on November 14, 1973, as well as in the Statutes of the BCEAO attached to the Treaty. Matters relating to monetary policy are also included in the cooperation agreement between the French Republic and the Member Republics of the WAMU and in the Operations Accounts Convention, concluded on December 4, 1973. However, the direction of policy was changed in 1989 when the objectives initially defined to support economic development in the region ceased to be the top priority (see the WAMU document titled: La nouvelle politique de la monnaie et du crédit de la BCEAO [The BCEAO's new monetary and credit policy], October 1989). This document is not on the BCEAO website.

114. Monetary policy is conducted at the regional level. Article 1 of the WAMU Treaty establishes a common currency and a regional Central Bank. Article 12 of this Treaty gives the Council of Ministers of the Union responsibility for monetary policy to be implemented by the BCEAO. The Council of Ministers also has the authority to change the parity of the regional currency.

115. Monetary policy is mainly determined by the fixed exchange regime. The main objective of monetary policy is price stability, to be achieved by preserving the external value of the currency (that is, to maintain the fixed parity with the euro), thanks to an appropriate coverage of the money supply by foreign exchange reserves along the lines of the cooperation agreements with the French Republic. Sales of CFA francs against foreign exchange are permissible when they are for commercial transactions, and the BCEAO centralizes holdings of all foreign exchange in the Union.[9] Since 1996, annual inflation targets have been set by the Council of Ministers of the Union at the end of each year for the following year, and they were first published in December 2000.

116. To reach these targets, the BCEAO uses two instruments to influence overall liquidity in the economy: required reserves and the reference rates. Since the early 1990s, in tandem with the rehabilitation of the banking system and the devaluation of the currency, the BCEAO's intervention instruments were modified as part of the shift from direct to indirect monetary management, and an interbank market was established. The BCEAO's instruments and the ways in which they are used are described in regulations sent to the banks.

117. Article 16 of the Statutes provides that the total amount of resources granted by BCEAO to any one-member state may not exceed an amount equal to 20 percent of that country's tax receipts in the previous fiscal year. At end-1998, the WAMU Council of Ministers decided to

---

[9] Banks may engage in foreign exchange operations on their own or on their customers' behalf, through their foreign correspondents. However, operations to cover their negative balances with these same correspondents must go through the BCEAO, in so far as they involve the sale of CFA francs against foreign exchange.

freeze the ceiling on statutory advances at the December 1998 level and to endeavor to eliminate them by end-2001.

118. The responsibilities of the states and the central bank in the following areas are clearly defined in Articles 29–36 of the Statutes: public treasury bookkeeping; management of treasury bills; foreign financial operations; domestic and foreign public debt management; conclusion and execution of international financial agreements; changes in the legal framework for the currency; and operations of the WAMU.

119. The general procedures whereby the BCEAO reports on its conduct of monetary policy are governed by Articles 69 and 70 of its Statutes. Any changes in monetary policy (changes in reference rates, or in the required reserve ratio, for example) are normally immediately made public via press communiqués. The texts of these communiqués usually provide a general explanation of the change announced and are becoming more and more detailed overtime.

120. The BCEAO publishes a statistical bulletin every month, and one each quarter, which includes an analysis outlining the implications of economic developments for the monetary situation and any likely impact on monetary policy targets. The publication lag of this survey is a minimum of three months.

121. Apart from one meeting early in the year, meetings with bankers are organized sporadically to announce changes in monetary policy (raising reference rates, or changing the base for the reserve requirement, for example). On the other hand, there are no regular meetings for the BCEAO to report on the latest monetary developments and obtain bankers' feedback.

122. The central bank publishes on a fairly regular basis an information series on monetary policy, the economic and monetary situations of the member states, and its accounts. The lag for sending monetary data to the Statistics department of the IMF, for publication in International Financial Statistics has been reduced from six months to three months. Senegal has not subscribed to IMF's Special Data Dissemination Standard, but intends to participate in the IMF's General Data Dissemination System (GDDS) in the months to come.

123. At the end of each week, the BCEAO reports its interventions on the money market (calls for bids, issuance of securities), if any take place. Every month, with a lag of at least three months, it publishes Information and Statistics Notices, which systematically present regional and national statistics on monetary situations, conditions of central bank interventions, rates used by banks, and stock market developments. These statistics are sometimes accompanied by explanations of monetary policy developments (economic climate, monetary aggregates, and central bank interventions), as well as studies on specific subjects. They are not posted on the website. Press communiqués on the meetings of the BCEAO Board of Directors and the WAMU Council of Ministers are circulated immediately after the meetings. However, the report of discussions is not communicated to the public.

124. The BCEAO annual report, as well as the Governor's report on the economic, monetary, and financial situation of member states, are fairly widely circulated about nine months after the end of the fiscal year.

125. The BCEAO created a communications directorate in August 1998 to provide a continuous information service to the public. It also set up a website, which contains information on the announcements regarding monetary policy measures, its founding legal instruments, publications, and statistics.

126. Article 70 of the BCEAO Statutes requires the Governor to submit an annual report on developments in the monetary situation of the Union and on the operations of the BCEAO to the Board of Directors of the Bank, as well as to the Council of Ministers and to the Heads of State of the Member States of the Union. Although not statutorily required to do so, the Governor also reports annually on the monetary situation to the WAMU Interparliamentary Commission.

127. The central bank is also required by Article 69 of its Statutes to prepare a monthly statement of its accounts. They must be published in the Bulletin officiel [official gazette] of each Member State.

128. The BCEAO also publishes its financial statements approved by its Board of Directors, with a lag of six months after the end of the fiscal year (Article 63 of the Statutes). These statements are audited in each country by national accountants, appointed by the Minister of Finance, and at the regional level by a Superintendent Auditor (*Commissaire Contrôleur*) appointed by the Council of Ministers of the Union (Article 64), in charge of centralizing the comments of the national auditors and of auditing the centralized accounts.

129. The profits of the BCEAO are published in the official gazettes of the Member States of the Union. The procedures for their distribution are defined in the BCEAO Statutes, but the distribution of profits is not published: this is the responsibility of the Council of Ministers. The amount of BCEAO capital is published and its distribution among member states is given in the Statutes, which also detail the procedures for covering any losses and for constituting the reserves required to consolidate its equity capital.

130. Article 47 of the Statutes provides that central bank staff is bound by professional secrecy. Article 48 provides that they may not take or accept any participation or remuneration whatsoever, by working for or advising any private or public enterprise, without a special exception being granted by the Governor. BCEAO staff is governed by special staff regulations, albeit unpublished ones.

Main findings

131. The transparency of monetary policy in the WAMU is overall satisfactory. Table 5 summarizes the main findings of the assessment of Observance of the MFP Transparency Code. Since the creation of the Union in 1973, its governing legislation instruments have spelled out the main objectives and the framework for implementing monetary policy so that all member states have a clear vision of the general strategies adopted in this area. Operating as a monetary union presupposes a high degree of institutional transparency. Relations between the BCEAO and the member states have accordingly been clearly stated.

Table 5. Summary of Main Findings of the Assessment of Observance of MFP Transparency Code—Monetary Policy

Subject	Main Findings
I. Clarity of roles, responsibilities and objectives of central banks for monetary policy	The objectives, the institutional framework, the link between monetary and fiscal operations, as well as the other roles of the central bank are defined in the BCEAO statutes and in the international treaties governing the WAMU. However, the focus of policy was changed in 1989 from the objectives originally set forth, without any change to the legal texts.
II. Open process for formulating and reporting monetary policy decisions	The institutional infrastructure for communicating monetary policy provides for some degree of transparency, recently augmented by the creation of a website. At the same time, communication between the BCEAO and financial sector participants could be strengthened.
III. Public availability of information on monetary policy	The central bank fairly regularly publishes an information series on monetary policy, the economic and monetary situation of member states, and its own accounts. It has created a website, which it is increasingly providing additional information. Senegal has not subscribed to SDDS or contributed to GDDS yet, but it intends to participate in GDDS in the months to come. Neither monetary data, nor official publications have been posted on the website yet.
IV. Accountability and assurance of integrity by the central bank	The Governor reports to the Board of Directors of the Bank, as well as to the Council of Ministers and Heads of State of the Members of the Union. He presents an overview of the monetary survey to the WAMU Interparliamentary Commission. The BCEAO operating account and its financial statements, duly certified by external auditors, are published annually, with a six-month lag.

132. Over the last several years, the BCEAO has endeavored to enhance the clarity of its monetary policy and to provide the public with better information about its mission, objectives, main activities, and decisions. It has officially embraced the principles contained in the Code of Good Practices on Transparency in Monetary and Financial Policies. In June 1998, it also inaugurated a website that is regularly updated. This site currently contains the founding texts (WAMU Treaty and BCEAO Statutes), a summary of the monetary policy framework, interviews with the Governor, the latest press communiqués, as well as information on central bank interest rates and the rates posted by the commercial banks. In addition, Senegal intends to participate in the IMF's General Data Dissemination System (GDDS) in the months to come.

Recommended next steps and authorities' response

133. According to commercial bank officials, the transparency process could be further enhanced by increasing the frequency of consultation with financial sector participants to provide them with an analysis of the monetary situation, outline the conduct of monetary policy, and obtain their feedback. The mission believes that the transparency process would benefit from posting monetary data on the BCEAO's website, periodically and at short intervals. Increased coordination with the Minister of Finance, with the prospect of new government securities being issued, is welcomed. Finally, it would be desirable to participate in GDDS as soon as possible.

134. The BCEAO and the Ministry of Finance gave their comments to the mission in January and July 2001. Most of these comments have been taken into account in this paper. The BCEAO officials noted that meetings between the representatives of the commercial banks and the National Director are held on a regular basis (about three times a year), and bilateral meetings are organized upon demand. The governor meets once a year with all of the regional bankers' associations.

SENEGAL: SUMMARY OF PRELIMINARY FINDINGS OF ASSESSMENT OF IMPLEMENTATION OF THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION[10]

CPs Main Categories	Main Findings
Objectives, Autonomy, Powers, and Resources (CP 1)	Budgetary decisions are taken outside of the Banking Commission, which is responsible for prudential supervision. While the Banking Commission is authorized to take appropriate measures to deal with problems and violations, the notification procedure could potentially reduce the effectiveness of prudential actions. There are not any formal agreements with other supervisory authorities of the financial system except France.
Licensing and Structure (CPs 2–5)	The Banking Commission is paying increasing attention to corporate governance issues. In April 2001, it sent a circular-letter to banks outlining new measures to improve corporate governance and risk management.
Prudential Regulations and Requirements (CPs 6–15)	Substantial progress has been made with issuance of prudential rules containing new minimum capital adequacy standards. Credit institutions have until January 1, 2002, to bring themselves into line with these. A Banking Commission circular on corporate governance introduces mandatory capital adequacy and risk ratios on a consolidated basis. However, as the Banking Commission statutes do now allow for such measures, the Council of Ministers will have to issue adequate and legally binding rules to that effect. Risk concentration limits are too high and should be reduced gradually. Existing prudential forbearance in this domain should also be curtailed. Senegal has no legislation or specific regulations against laundering of the proceeds of crime, other than the law to combat drug trafficking. A working group (BCEAO and FATF) is in the process of preparing a regional legislation to be adopted by 2002.
Methods of Ongoing Supervision (CPs16–20)	There is room for improvement in provisions for on-site and off-site supervision: • Concerning off-site supervision, the move toward the automatizing of the transmission and processing of data received by banks was welcomed, but electronic transmission only encompasses the accounting data and not the prudential ones, which are still collected on paper forms. • For on-site inspections, it is regrettable that the number of staff assigned to on-site inspections declined from 27 in 1998 to 20 in 2000. The authorities noted that expected resources for 2001 would allow the Commission to conduct on-site inspections of banks in the regions every three years, compared with the every-other-year time span up to now. A strategic human resources plan should be developed to allow inspections every two years.
Information Requirements (CP 21)	The circulars and prudential rules provide guidelines covering all main elements. There is no directive on trading and other securities activities, or on derivatives or asset securitizations.
Formal Powers of Supervisors (CP 22)	Some credit institutions persist in repeated, contraventions of legislation and regulations. Moreover, some important credit institutions have been placed under close surveillance by the Banking Commission. Prudential forbearance should be adequately sanctioned and curtailed.
Cross-border Banking (CPs 23–25)	Procedures and a system specifically for supervising the activities of banking institutions operating outside the WAEMU member states are needed. Substantial progress has been made in developing an agreement with French banking supervisors.

[10] These preliminary findings are subject to further revision.

INTERNATIONAL MONETARY FUND

SENEGAL

Financial System Stability Assessment

Prepared by the Monetary and Exchange Affairs and African Departments

Approved by Stefan Ingves and G.E. Gondwe

August 24, 2001

This Financial System Stability Assessment (FSSA) is based on the work of the joint IMF/World Bank mission that visited Senegal as part of the Financial Sector Assessment Program (FSAP) in November 2000 and January 2001. The FSAP mission's findings were discussed with the authorities in July 2001 in the context of the 2001 Article IV Consultation. The FSAP team was composed of Piero Ugolini (IMF, Mission Chief), Anne Rennie (World Bank, Deputy Mission Chief), Mark Zelmer, Christine Sampic, and Sandra Marcelino (all IMF), Luc Cardinal, Carlos Cuevas, Elena Folkerts-Landau, Charlie Garrigues, Daria Goldstein, Gregorio Impavido, Andres Jaime (all World Bank), Kalidou Gadio (African Development Bank), Arnaud de Villepoix (Consultant-Banque de France), Brian Gelfand (Consultant-IOSCO), and Marcel Maes (Consultant-Belgium).

The banking system in Senegal has gradually regained health and is generally well regulated and supervised. The Senegalese authorities and the regional central bank, the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO), have addressed most of the problems that caused the banking crisis of the 1980s in order to avoid a repetition of similar problems. The lack of banking supervision has been successfully addressed by the creation of the regional Banking Commission followed by effective supervision. Government ownership and interference in the banking sector has been significantly reduced. However, the economy remains vulnerable to the same external and domestic policy factors (e.g., prices on oil, groundnuts, and domestic energy), which, in turn, could affect the stability of the banking system. This vulnerability is compounded by the high concentration of credit risk in bank loan portfolios and emerging inefficiencies in the judicial system related to the foreclosure process. Notwithstanding these vulnerabilities, the probability of a major systemic crisis is low, insofar as there is the capacity of the public enterprises or the government to repay bank loans.

Other financial sectors (insurance, pension, microfinance, and capital markets) are fairly small and at an early stage of development, and thus do not constitute a source of systemic risk even though they all suffer from a number of weaknesses. Owing to a limited regional interbank market, liquidity does not flow smoothly across the member countries of the West African Economic and Monetary Union (WAEMU), but there have not been any liquidity crises. The current obsolete manual payment system is being replaced by a new system that will comply with international standards by 2002. No systemic risks were found in this area, inasmuch as most transactions are conducted using cash. Since Senegal is a member of the WAEMU region, monetary policy and financial sector supervision are conducted for the region as a whole by regional institutions. Therefore, the assessments made in the context of Senegal apply for the region as a whole. There was partial observance of IOSCO principles. The transparency of monetary policy is satisfactory overall. A preliminary assessment of the Basel Core Principles was made.

Areas that need to be addressed to strengthen the financial sector further are: domestic pricing policy, the legal framework, and the high concentration of credit risk. In the future, strict coordination between the BCEAO and Ministry of Finance to facilitate the management of public debt will be required when Senegal and other countries in the region begin issuing public debt in the market. Action in this latter area is already under way.

This report was prepared by Piero Ugolini and Mark Zelmer.

Table of Contents Page

Figures

Appendices

Glossary

AT/CPEC	Assistance Technique aux Caisses Populaires d'Epargne et de Crédit
ADB	African Development Bank
BCEAO	Banque Centrale des États de l'Afrique de l'Ouest
BRVM	Bourse Régionale des Valeurs Mobilières
CIMA	Conférence Interafricaine des Marchés Publics d'Assurance
CIPRES	Conférence Interafricaine de la Prévoyance Sociale
CRCA	Commission Régionale de Contrôle d'Assurance
CREPMF	Commission Régionale de l'Épargne Publique et des Marchés Financiers
DC/BR	Dépositaire Central/Banque de Règlement
DNA	Direction Nationale des Assurances
FATAF	Financial Action Task Force
FDIC	Federal Deposit Insurance Corporation
FNR	Fond National de Retraite
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
GDDS	General Data Dissemination System
IAIS	International Association of Insurance Supervisors
ICS	Industries Chimiques du Sénégal
IOSCO	International Organization of Securities Commissions
IPRES	Institution de Prévoyance Retraite du Sénégal
MFI	Microfinance institutions
MFP	Monetary and Financial Policies
NBFI	Nonbank financial institutions
OHADA	Organisation pour l'Harmonisation en Afrique du Droit des Affaires
SAR	Société Africaine de Raffinage
SDDS	Special Data Dissemination Standard
SENELEC	Société Nationale d'Électricité
SGP	Société de Gestion de Patrimonie
SODEFITEX	Société de Développement des Fibres Textiles
SONACOS	Société Nationale de Commercialisation des Oléagineux du Sénégal
SRO	Self-Regulatory Organization
SNR	Société Nationale de Recouvrement
WAEMU	West African Economic and Monetary Union
WAMU	West African Monetary Union

OVERALL ASSESSMENT

1. **Senegal's financial sector is dominated by ten commercial banks, which account for more than 85 percent of total financial sector assets.** Banks controlled by international financial conglomerates make up almost 80 percent of banking system assets. Insurance companies account for most of the remainder of total financial sector assets, and there is an embryonic securities market. Microfinance institutions' activities are growing very rapidly and reaching an increasing share of households, small enterprises, and informal sector business. With the exception of the regional development bank, the African Development Bank (ADB), there are no development financial institutions operating in Senegal, but there are two banks that specialize in providing agricultural credit and housing loans, respectively.

2. **The *banking system* in Senegal has gradually regained health and is generally well regulated and supervised.** However, nonperforming loans, as a share of total private sector loans, albeit relatively low, are on the rise. The Senegalese authorities and the regional central bank, the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO), have addressed most of the problems that caused the banking crisis of the 1980s in order to avoid a repetition of similar problems. The Senegalese authorities' objective is to build a stronger financial sector capable of supporting a higher rate of economic growth necessary to reduce poverty and unemployment as part of the PRGF program. As of April 2001, financial sector assets represented 39 percent of GDP.

3. **The major vulnerabilities of the past fall into four main categories: (i) lack of supervision; (ii) substantial government ownership and interference in the banking sector; (iii) a narrow economic base, which left the country and its financial system highly exposed to shocks in the areas of groundnut production, export and petroleum import prices; and (iv) the effects of some government policies in the setting of producer prices for groundnuts and domestic energy prices.** The lack of supervision has been successfully addressed by the creation of the regional Banking Commission and effective supervision. Government shareholdings in the banking sector and interference in the day-to-day management of banks have been significantly reduced. However, the economy continues to remain vulnerable to external shocks and government policies in the setting of producer prices for groundnuts and domestic energy prices, which, in turn, could seriously affect the stability of the financial system. This vulnerability is compounded by the high concentration of credit risk in bank loan portfolios.

4. **The high concentration of credit risk in bank loan portfolios is unavoidable given that banks have little scope for further portfolio diversification.** In addition, the banks are earning wide spreads in their current lending activities that are mainly focused on loans to the largest enterprises. While wide spreads make it easier for the banks to absorb external shocks, they may reduce the incentive to seek out lending opportunities that may exist among small- and medium-sized businesses and the household sector. (This may partly explain the growing microfinance sector). Moreover, risks associated with lending to the latter are high due to some problems in the legal system (discussed below) and the lack of reliable information on the financial condition of prospective borrowers because of existing problems in the accounting and corporate governance systems. The problems encountered by the banks' exposures to SONACOS and SENELEC in 2001 are clear examples of the potential vulnerabilities that exist in the banking sector. These are highlighted in the stress test exercise.

5. **Notwithstanding these vulnerabilities, the mission is of the view that the probability of a major systemic crisis is low.** A number of major factors contribute to the resilience of the system. They are: (i) the introduction of permanent, systematic supervision mechanisms; (ii) enhanced governance; (iii) modernization of bank management; (iv) regulation of financial activities at the regional level; and (v) the implementation of preventive policies. Additional factors are the membership of Senegal in the West African Economic and Monetary Union (WAEMU), which ensures that shocks to Senegal are not compounded by inflation and exchange rate uncertainties, and the low level of monetization in Senegal. Finally, the embryonic state of the interbank market, and the current high level of liquidity in the banking system make a contagion effect in the event of a bank failure unlikely. There remains, however, a risk of contagion from the banking sector to other financial subsectors, since both insurance companies and microfinance institutions maintain large deposits with the banks.

6. **Other sectors of the financial system in Senegal are fairly small and underdeveloped, and thus do not pose major sources of systemic risk.** ***Insurance companies***, which account for 10 percent of total financial assets, present a number of weaknesses: low minimum capital; weak licensing procedures; lack of internal control procedures; little use of reinsurance; and a lack of on-site inspectors. In addition, the ability of insurance companies and pension funds to invest in a diversified range of longer-term investments is hindered by a lack of suitable domestic investments and the difficulty of investing offshore because of existing arrangements surrounding the convertibility guarantee of the CFA franc, which effectively preclude such investment. As a general rule, the larger companies appear to be profitable, while the smaller ones are encountering difficulties.

7. **While the *pension system* in Senegal does not pose systemic risks for the financial system, its current financial position is unsustainable in the medium and long term, and may have a significant budgetary impact if fundamental reforms are not undertaken.** The Senegalese government is well aware of this problem and has made pension system reform one of its priorities.

8. ***Capital markets*. The regional stock exchange in Abidjan is a relatively new component of the financial system in the WAEMU, having commenced operation in September 1998.** Senegal has only one company listed on the exchange. At this stage of development, the financial market has not yet reached the volume of activity necessary to cover all of its operating costs, including those of the supervisory system. In addition, owing to this low level of activity, intermediation costs are high, which further limits the market's liquidity.

9. ***Microfinance* development in Senegal has kept pace with the dynamic evolution of this sector in the WAEMU region.** In Senegal, the number of institutions and their membership has reportedly grown to about 18 percent of the households. Deposit balances in microfinance institutions (MFIs) have increased in relative importance vis-à-vis bank deposits from the equivalent of 1 percent in 1996 to 2.4 percent as of June 2000. Aside from the three dominant MFIs, there are a large number of entities with small membership and weak institutional structures. The lack of appropriate supervision framework is the key problem.

10. **The *legal framework* governing the financial sector in Senegal is quite comprehensive, covering most areas.** However, the functioning of the Senegalese judicial

system, which has traditionally been recognized as quite satisfactory, is currently becoming a matter of some concern, since delays in the foreclosure process compound the credit risk in the financial system. The development of the justice system in Senegal has not kept pace with the growth of the financial sector. Several factors need attention: (i) the system can be quite slow; (ii) the judicial infrastructure is inefficient; (iii) no modern information system exists to collect all relevant information regarding court cases; and, (iv) on the whole, decisions are not systematically published. The financial community is now often critical of the functioning of the judicial system, especially certain banks, which have expressed doubts about the competency and the quality of the decisions of some judges in financial matters.

11. ***Liquidity management.* Owing to the small number of intraregional interbank operations (with the exception of intragroup operations), liquidity does not flow smoothly across the member countries of the Union, and the BCEAO does not engage in regular open market operations.** Reserve requirements are at times used to manage liquidity in each country. Reserve ratios are not uniform across the Union and Senegal's ratio, at 9 percent, is one of the highest in the region. There have not been any liquidity crises.

12. **The current manual *payment system* is slow and obsolete. It does not meet the needs of a modern economy or an active interbank market.** The weaknesses of the system have been clearly identified by the BCEAO, which has launched a reform project at the regional level with the help of the World Bank, to establish a system that complies with international standards by 2002. Despite the weaknesses of the current system, no systemic risks were found by the mission since most transactions in the economy are conducted in cash.

Compliance with international standards and codes

13. Since Senegal is a member of the WAEMU region, monetary policy and financial sector supervision are conducted for the region as a whole by regional institutions. Therefore, the assessments made in the context of Senegal apply for the region as a whole.

> ***– Basel Core Principles*:** Only a preliminary assessment was made. A final assessment is envisaged to be made in the context of the forthcoming FSAP mission to Côte d'Ivoire. Appendix I summarizes the main findings. **The banking supervision system has improved significantly in recent years**: a system of accounts has been introduced; new circulars call for internal control and audit functions to be strengthened; and the prudential system sets new licensing requirements and management standards, including capital adequacy and risk coverage standards. Moreover, a circular letter on corporate governance was issued recently. In the case of money laundering, work is under way to introduce legislation on a regional basis in this area by 2002.

> ***– IOSCO*: Although the regulatory and supervisory framework for the financial market is quite new, a regulatory and supervisory system is already operational.** This system generally observes the objectives and principles for financial regulation established by IOSCO, since most of these principles are fully or partially applied. However, some key principles are not, especially in the following areas: supervision of the secondary market, prudential regulations and management of the risks of

intermediaries, and exchange of information and instances of coordination with other regulators.

– *Monetary transparency*: **The transparency of monetary policy in the WAEMU is satisfactory overall.** Since the establishment of the Union in 1973, its governing laws have set out the general objectives and framework for the implementation of monetary policy so that all member states can have a clear view of the policy directions taken. In recent years, the BCEAO has endeavored to improve the readability of its monetary policy and the information provided to the public on its mission, objectives, main activities, and decisions. Commercial bank representatives believe that the transparency process could be enhanced by increasing the frequency of consultation. The BCEAO officials noted that meetings with the National Director (about three times a year) are held on a regular basis, and bilateral meetings are organized upon demand. In addition, the governor meets once a year with all of the regional bankers' associations.

14. **In order to cope with future challenges, the Senegalese authorities and the BCEAO have embarked on a series of steps aimed at further strengthening the macroeconomic framework and the soundness of the financial sector.** These include: (a) continuing to implement prudent fiscal and monetary policies and addressing regulated domestic price policies; (b) increasing the level of openness and transparency in economic and financial decisions and activities; (c) eliminating direct central bank financing of the government and developing a regional government securities market; (d) introducing a modern payment system; (e) promoting the development of an active regional money and capital market; (f) improving the implementation of laws; and (g) strengthening the supervision of insurance and microfinance institutions and the financial market. **While these efforts are to be commended, additional areas need to be addressed to further strengthen the financial system.**

a. **Legal framework: The slowness and growing inefficiency of the judicial system is a matter of serious concern.** Additional human and technical resources, as well as training and specialization of court officials, should be provided to correct the problem.

b. **The banking system remains exposed to the high concentration of credit risk, in particular for indigenous banks that have little scope for further portfolio diversification.** The authorities should make efforts to alleviate the concentration of credit risk in bank loan portfolios by more rigorous application of prudential limits on risk concentration. In addition, consideration should be given to introducing credit bureaus that could gather and disseminate information on prospective borrowers.

c. **In the case of banks in serious or irreversible difficulties, rapid action by the supervisory authority can be critical to ensure depositor protection.** In this regard, the role played by the national Ministers of Finance in the appointment of temporary administrators or notification of the withdrawal of a license, and the suspensive effect of possible actions are not very well suited to specific situations. Once a deposit insurance system is in place, the authorities should plan to transfer all responsibility for the appointment of temporary administrators and notification of the withdrawal of licenses to the Banking Commission in order to improve the efficiency of the supervisory authority.

d. **For the insurance sector, fit and proper tests should be implemented, minimum capital increased, principles of corporate governance and internal controls applied, reinsurance encouraged, and resources allocated to supervisory agencies augmented so as to increase the frequency and scope of on-site inspections.**

e. **The BCEAO has made significant progress in disseminating regulations, information, and laws related to the financial sector.** However, representatives of the financial sector told the mission that they would like to **meet more frequently** to exchange views on issues of common interest.

f. **Quick changes need to be made to the benefits of the pension system, while continuing the analysis and dialogue on its structural reform.** Parameters in need of change include: enlarging the contribution base, strengthening the link between contributions and benefits, and tightening entitlement rules.

g. **Microfinance in Senegal is a growing sector, which serves a very large segment of the population, in particular low-income groups and the informal sector.** However, the growing number of institutions has created problems of supervision. The licensing of new institutions should be closely monitored until an assessment of the state and performance of existing institutions can be made. The advisability of evaluating the creation of a special supervisory body should be evaluated and coordinated with the interested parties.

h. **The development of an efficient payment system, together with better circulation of information and communication among banks in the region and the creation of standard instruments (such as repurchase agreements), are essential to improve the liquidity management system.** The efforts to fully develop a **regional interbank market** are strongly supported. The ongoing modernization of the payment system will be the first step in achieving such a goal. Additional measures (such as the use of collateral) and initiatives to encourage the exchange of information and communication among banks and countries in the region will be essential for its development. More frequent use of open market operations to adjust short-term liquidity fluctuations would be desirable once that government securities are introduced in the union. Close cooperation between the BCEAO and the Ministry of Finance to facilitate the **management of public debt** in the future is welcomed and encouraged.

i. The authorities should make efforts to reach full compliance with all of the international standards and codes.

SECTION I—STAFF REPORT ON FINANCIAL SECTOR ISSUES

I. Financial Sector in Senegal

15. The financial sector consists of 10 commercial banks, 4 nonbank financial institutions (NBFIs), a government-owned postal savings network, 5 life insurance companies, and 10 "non-life" ones, and about 500 microfinance institutions. Almost all institutions are privately owned—in the case of most of the large banks by foreign banking conglomerates—even though the government still holds almost 25 percent of the capital of three commercial banks. There are also two local pension schemes—Fond National de Retraite (FNR) and the Institution de Prévoyance Retraite du Sénégal (IPRES)—and a region-wide social security system (CIPRES). However, they only serve a small portion of the population. The local capital market mainly consists of an interbank market that primarily deals on an overnight basis; there is also a regional securities market headquartered in Abidjan, Côte d'Ivoire, serving the WAEMU region. The BCEAO is working with the financial sector to introduce a real-time gross settlement payment system for the region.

16. The degree of financial development in Senegal is low. For example, M2 as a percent of GDP was about 25 percent in the WAEMU region in 2000 compared to 57 percent in South Africa. It is nonetheless higher than in the Central African Economic and Monetary Community (less than 10 percent in 2000). The financial sector is dominated by the banks, which control more than 85 percent of financial sector assets (Table 1), although the registered microfinance institutions have grown rapidly over the past several years, and numbered 492 institutions (June 2000), with total credit outstanding of CFAF 15.8 billion (US$25 million equivalent) and total deposits of CFAF 17.2 billion (US$27 million equivalent). There are also a large number of informal savings groups.

Table 1. Senegal: Total Assets of Financial Institutions

(As of April 2001)

Institutions	CFAF (In Billion)	Percent of Total	Percent of 2000 GDP
Banks	1,075.2	88.5	34.6
Nonbank financial institutions 1/	12.1	1.0	0.4
Insurance companies 1/	114.0	9.4	3.7
Microfinance institutions 1/ 2/	13.6	1.1	0.4
Total	1,214.9	100.0	39.1

Sources: Senegalese authorities and Fund staff estimates.

1/Only information for December 1999 is available.

2/Total deposit liabilities, since data on total assets were not available.

17. Following the financial crisis at the end of the 1980s, WAEMU members introduced modern laws and regulations to supervise the activities of commercial banks and other credit-granting institutions. As part of this endeavor, the WAEMU Banking Commission was created to supervise the 91 banking institutions operating in the region. It is composed of representatives

from each state of the Union, and chaired by the Governor of the BCEAO. The Secretary General of the Banking Commission is responsible for implementing decisions and recommendations with the help of staff that have been seconded from the BCEAO.

18. Other regional financial system supervisory bodies include: the Commission Régionale de Contrôle d'Assurance (CRCA), which was founded in 1992 to supervise the insurance industry; and the Conseil Régional de l'Épargne Publique et des Marchés Financiers (CREPMF), the main regulatory and supervisory body for the securities market, which was established in November 1997. Microfinance institutions are supervised on a national basis by the Cellule (Unit) AT/CPEC at the Ministry of Economy and Finance.

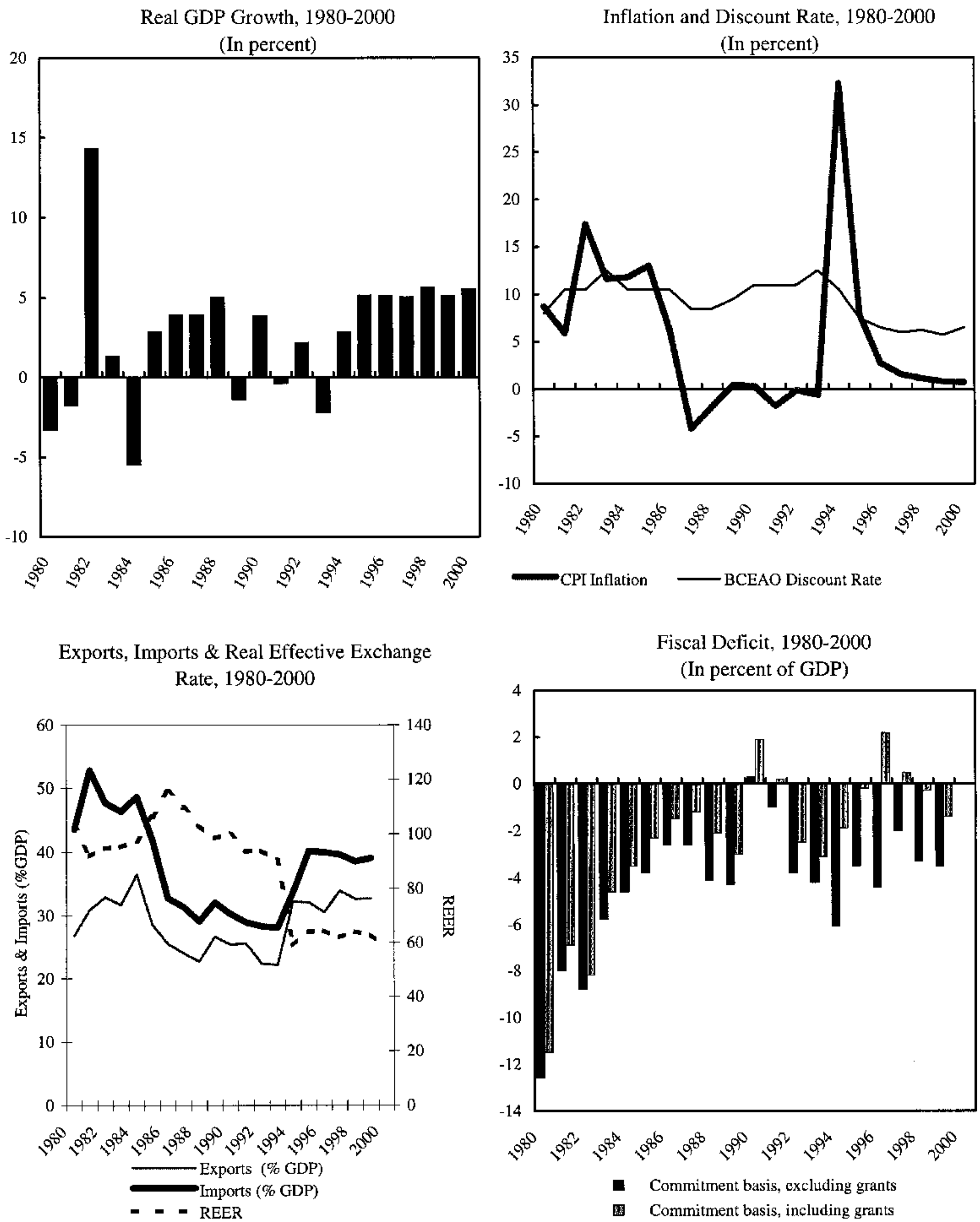
II. Macroeconomic Factors Affecting the Health of the Financial System

19. Senegal is the second largest member of the eight-country WAEMU region, accounting for about 17 percent of the Union's economic activity. However, the overall level of development in Senegal is low, with a per capita income of about US$500 in 2000. WAEMU members share a central bank, the BCEAO, whose currency the CFA franc, has been pegged to the euro under a special convertibility arrangement with the French Treasury. This arrangement helps to protect the financial system from volatile capital flows, since the banks are not allowed to carry significant open foreign exchange positions and domestic investors are not allowed to invest offshore. Monetary policy is conducted at the regional level by the BCEAO with the objective of sustaining price stability and maintaining the fixed exchange rate with the euro. The WAEMU institutional framework provides for convergence criteria, among others, on the primary fiscal surplus, nonaccumulation of arrears, and the wage bill as a percentage of fiscal revenue to complement the guaranteed convertibility by the French Treasury.

20. Real GDP growth has averaged about 5 percent annually since the mid-1990s, after having experienced a period of sluggish growth in the late 1980s/early 1990s (Figure 1). The exchange rate realignment of January 1994 led to a significant turnaround in economic activity, with output, exports, and investment increasing rapidly in the latter half of the 1990s. Inflation, after a brief surge in the aftermath of the devaluation, has returned to low levels. Good economic management, the continued implementation of structural reforms, and the remaining positive effects of the CFA franc devaluation stimulated the Senegalese economy over the period. Following the devaluation, private sector credit initially contracted as banks wrote-down their bad loans, but has since recovered. Broad money grew in line with the growth in nominal GDP until 1998 (Figure 2), but accelerated in 1999 and 2000. This led the BCEAO to tighten its monetary policy stance in August 2000—the intervention rate was raised by 75 basis points in June 2000, and commercial bank reserve requirements in Senegal were increased from 3 percent to 9 percent—to keep inflation low.

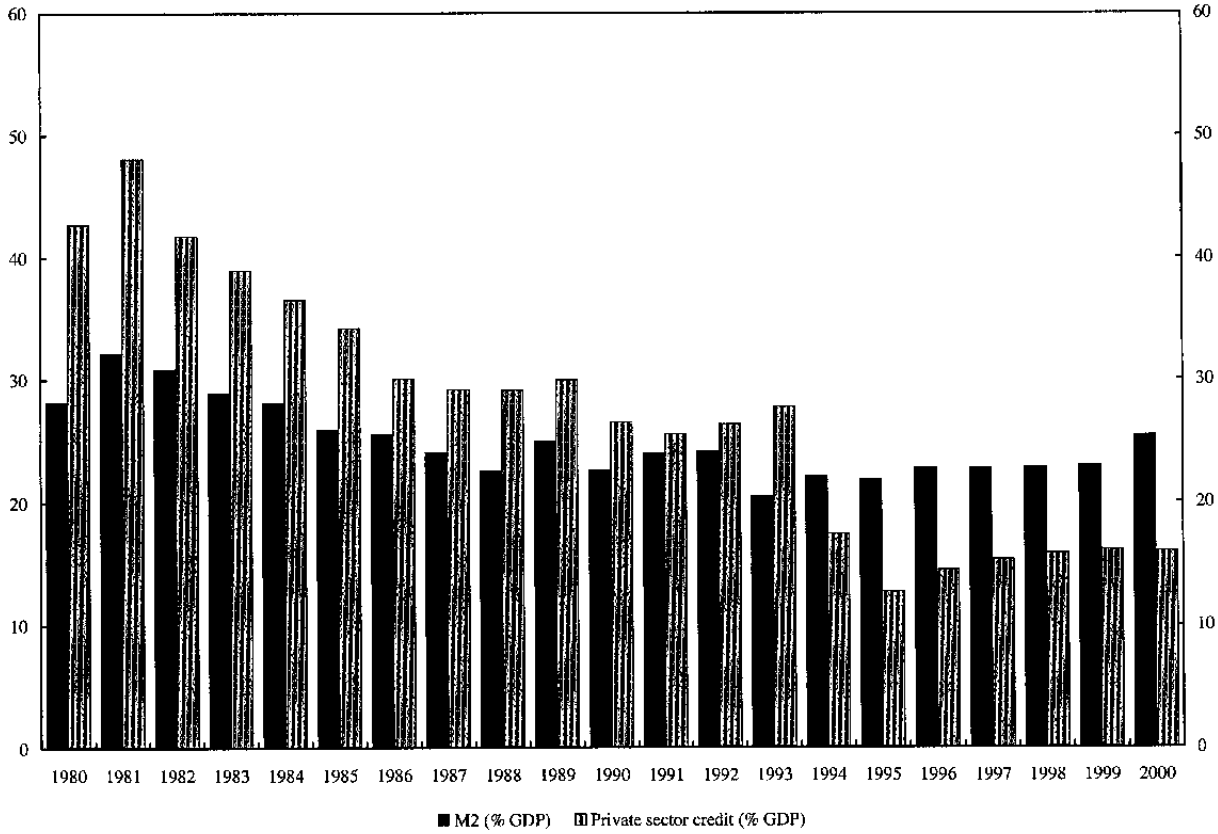
21. Despite the favorable economic performance observed in recent years, the country's narrow economic base leaves it vulnerable to macroeconomic shocks. The major shocks that often affect Senegal are: unexpected declines in prices of key export commodities (groundnut-, phosphate-, and fish-related products constitute more than one-third of total exports); higher oil

Figure 1. Senegal: Macroeconomic Indicators



Sources: Senegalese authorities; and Fund staff estimates.

Figure 2. Senegal: Broad Money and Private Sector Credit, 1980–2000
(In percent of GDP)

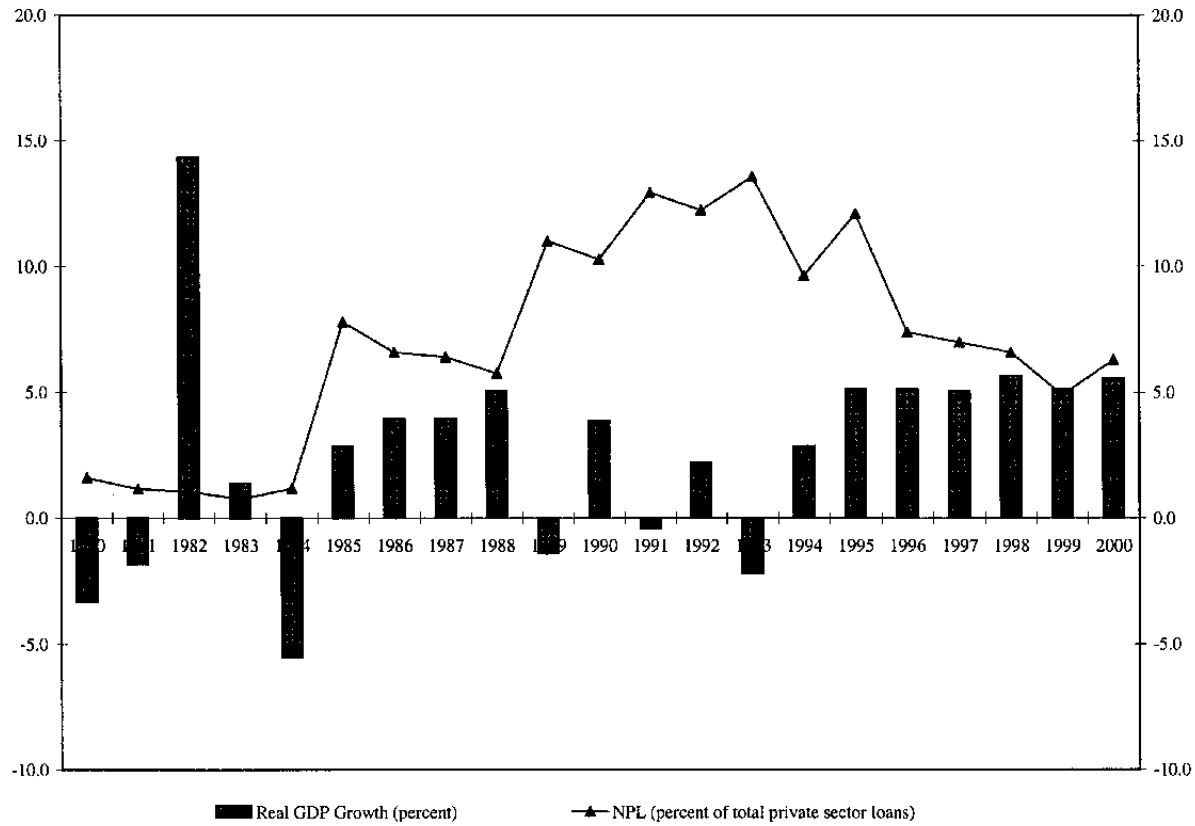


Sources: Senegalese authorities; and Fund staff estimates.

prices; and climatic conditions, which can significantly affect agricultural crops. Adding to these potential vulnerabilities are government-regulated producer prices for groundnuts and domestic energy prices, which at times are adjusted to changes in market prices with a lag. Since banks are actively engaged in providing financing to these sectors, these shocks and policies could have significant effects on the health of the financial sector through their impact on the credit risk of bank loan portfolios.

22. A simple illustration of the relationship between macroeconomic developments and the health of the financial sector is to compare movements in real GDP with the level of nonperforming loans in bank loan portfolios (Figure 3). The economic difficulties of the late 1980s/early 1990s undermined the credit quality of bank loan portfolios, triggering a tripling in the level of nonperforming loans as a share of total loans to the private sector. The need to provision against these loans eliminated bank profits in the late 1980s/early 1990s, and contributed to the failure of six banks. The nonperforming loans were consolidated by the BCEAO, and a specialized institution, the Societé Nationale de Récouvrement (SNR), which was established in 1991 to recover these loans. Despite this financial restructuring, the banking system remained weak prior to the January 1994 CFA franc devaluation, owing to loan repayment difficulties, low demand for credit, and a decline in bank deposits in anticipation of an exchange rate devaluation.

Figure 3. Senegal: Real GDP Growth and Nonperforming Loans, 1980–2000



Sources: Senegalese authorities; and Fund staff estimates.

23. Following the exchange rate adjustment, the economic situation became more robust, and the level of nonperforming loans gradually returned to pre-crisis levels. The banks experienced a surge in liquidity as a result of strong capital inflows, combined with initial weak demand for credit. After 1996, this excess liquidity diminished progressively as Senegal's economic recovery took hold and credit demand increased; meanwhile, the growth in deposits remained more moderate. The profitability of the banks consequently increased, and the banking environment became more attractive.

24. In late 2000, Senegal sought and received a rating by Standard & Poor's, the first country in the WAEMU to have ever done so. The sovereign rating of B+ for long-term loans places Senegal at a par with countries such as Brazil, Bulgaria, and Lebanon, which bodes well for the country's medium-term potential access to international capital markets. When announcing the rating, Standard & Poor's noted that the decision is supported by Senegal's membership in the WAEMU, and expectations that the government will continue to adhere to its program of structural reforms. The rating agency also noted that while the level of government debt in Senegal is well above the median for other countries in this rating category, the economic burden and liquidity risk associated with Senegal's debt is mitigated by the fact that almost all of it is external and concessional in nature.

III. Robustness of the Financial Sector

A. Banks

Banking system overview

25. The banking system in Senegal has gradually regained health and is generally well regulated and supervised, as indicated by the preliminary assessment of compliance with the Basel Core Principles. The Banking Commission and the BCEAO have addressed most of the problems that caused the banking crisis of the 1980s. However, the banks are still very vulnerable with respect to government pricing policies, external factors, and risk concentration.

26. The banking system is dominated by foreign banking groups, mainly French and one American. Although the French banks are majority-owned subsidiaries of their parents, the local Citibank operation is a branch of Citibank, N.A. Seven banks, accounting for almost 80 percent of the balance sheet of the banking system, are controlled by shareholders resident outside the WAEMU area. This means that the Senegalese banking system continues to depend largely on foreign interests. However, to the extent that these represent reputable international banking groups, the authorities consider this a source of strength for Senegal. Furthermore, the quality of the system is reinforced by the fact that the three Senegalese banks that are subsidiaries of French banks are more than 50 percent owned by their parent banks. Thus, their accounts are consolidated at the level of the parent institution.

27. The government's progressive divestment of its interests in the banking system is also noteworthy. The government's stake in each of the seven banks in which it has an interest is now less than 25 percent; majority control of the banking system is now in the hands of private interests, and the government is no longer involved in managing the day-to-day affairs of banks in which it has a stake. This compares favorably with the period prior to the bank restructuring when the government was the largest shareholder in seven banks and owned 35 percent of another, and often interfered with their day-to-day activities. Clearly, the role of the public authorities cannot be solely judged on the basis of their ownership interests in banks; however, the unanimous opinion of bankers in Senegal is that previously excessive government interference has been curtailed. Although the authorities may encourage lending in some strategic sectors, such as agriculture, the government has clearly ceased to exert pressure on certain types of lending, and no longer interferes in the internal management of institutions.

28. It should also be noted that the BCEAO continues to be a minority shareholder in two banks that specialize in agriculture and housing financing—although this represents less than 1.5 percent of the capital in the banking system. This is a holdover from the past when these banks needed stable sources of funds and the particularly sensitive sectors in which they were involved required strict management. Today, the BCEAO plays only an advisory role. Its intention to eventually divest its stakes in these two banks is welcomed.

29. The savings products offered by banks are term deposits (one month is reportedly the most popular term), savings accounts earning 3 percent, and noninterest-bearing sight deposits. There are no mutual funds or money market funds. Except for a specialized housing bank, which focuses on supplying real estate construction and mortgage financing for households, financing provided by the banks is generally for terms of up to 10 years, with variable interest rates that are tied to the banks' base lending rates.

30. Although complete data are not available, bank officials report that they obtain most of their funding from retail deposits (deposit liabilities represent 75 percent of the system's balance sheet). Sixty-eight percent of the deposit base consists of sight or notice deposits, which despite being redeemable on demand, tend to be a stable source of funds. With the exception of the housing bank, term deposits typically have maturities of one month, and here again the trend has been to regularly roll these over since the period of bank restructuring and currency devaluation. Those issued by the housing bank are non-redeemable and have maturities ranging up to four years. The remainder of the banking system's liabilities consists of: (i) bonds issued by banks to institutional investors to provide longer-term fixed-rate funding; (ii) interbank financing; and (iii) capital and reserves for doubtful loans.

31. Funds are primarily lent to Senegalese enterprises, of which four dominate the sector (SONACOS, SENELEC, SAR, and ICS). At April 30, 2001 total loans to the private sector stood at CFAF 683 billion (63 percent of total assets), of which CFAF 410 billion was short term (two years or less) and CFAF 222 billion medium and long term.[1] On a far smaller scale is the placement of funds in treasury and interbank instruments and in government guaranteed securities, most of which were issued during the period of bank restructuring.

32. The concentration of loans accorded to Senegal's largest enterprises was such as of April 30, 2001 that seven banks exceeded the prudential limit on risk concentration.[2] Credit to small and medium enterprises has been constrained, however, by the absence of credit assessment tools. Smaller borrowers do not tend to provide financial data about themselves, which leads to inadequate track records for most candidates. Moreover, the banks themselves have failed for the most part to establish adequate information technology that might otherwise enable them to classify accounts, generate reports, track loan performance, and generally perform the tasks inherent in reliable data management and risk management. As a result, they lack the capacity to lend effectively to a large number of smaller enterprises. There appears to be some hesitation in extending credit to small- and medium-sized enterprises whose viability is not clearly documented owing to incomplete accounting practices and financial disclosures. However, in the wake of difficulties with lending to SONACOS and SENELEC, some banks have begun expanding their branch networks this year in order to seek out lending opportunities among smaller borrowers as a means of diversifying their loan portfolios. The larger banks also have sizable holdings of government securities acquired during the bank restructuring period, which require no credit assessment capacity, yield 5 percent after tax, and can be used without penalty to secure temporary financing from the BCEAO, in addition to meeting reserve requirements.

33. Profitability in the banking sector was buoyant in the second half of the 1990s following the government sponsored program of bank restructuring in the late 1980s–early 1990s, and the currency devaluation in 1994 (which catalyzed economic activity) (Table 2). Banks owed their improved profitability to an interest margin that has exceeded 400 basis points since 1995.

---

[1] Loans of two years or less are viewed as short-term loans as per the reserve requirements on short-term loans.

[2] Under this regulation, the combined amount of loans representing more than 25 percent of a bank's capital cannot exceed eight times that of capital.

Banks' need to maintain interest margins at such levels is due primarily to high loan loss provisions, which net of recoveries have averaged 1.70 percent of total bank assets since 1995. Further integration into the WAEMU payment system may increase competition and narrow spreads, as may the future reduction of exposures to public enterprises. However, there is a risk of collusion in such a small and concentrated market.[3] The classification of loans and provisioning requirements appears to be adequate.

34. The comfortable interest margins enjoyed by all Senegalese banks, however, mask a number of trends that may potentially undermine profitability in the near future. Overhead costs may rise in the short run as information technology is introduced and strengthened and as some banks expand their branch networks. Although the level of nonperforming loans (NPL) is moderate, stricter provisioning for loan losses and the regulatory requirement to boost risk-adjusted capital levels to 8 percent by January 2002 may reduce that part of bank profits that might have been distributed as dividends. Clearly, on a sustained basis, both of these measures are expected to strengthen bank solvency. Profitability may also be constrained by the absence of opportunities for banks to diversify risk. Cross-border lending within the WAEMU region remains difficult.

35. Since 1996, the Senegalese banking system's capital base has been considerably strengthened, despite the extensive provisioning recorded in recent years. Bank capital rose from CFAF 27.8 billion in 1996 to CFAF 77.2 billion at April 30, 2001, though the number of institutions increased by only one. In April 2001, nine of ten banks had a risk-weighted capital ratio exceeding the 8 percent threshold set by the authorities. The one exception did not meet this condition because of sizeable additional provisioning and a change in the method of calculating its capital.

36. Given the rebuilding of the banking system's capital base, the stability of the Senegalese banking system in a prudential sense has improved somewhat in recent years. The number of violations of prudential regulations is limited, and those that remain mainly concern the concentration of credit risks and the transformation ratio.

37. With respect to the concentration of credit risks, banks are becoming increasingly exposed to the large parastatals, notably SONACOS and SENELEC, and also to petroleum companies operating in Senegal. As a result, the number of banks that do not adhere to the prudential limit on risk concentration has grown from five to seven between June 2000 and April 2001. The petroleum companies are having to borrow from the banks because SENELEC has been slow to pay them for purchases of petroleum. Although SONACOS is increasingly able to diversify their funding sources (borrowing directly from foreign banks offshore, and accessing capital markets for needed funds), this is a double-edged sword because it had to give these creditors priority claims on the proceeds from future sales of groundnut products. Such actions undermine the quality of the local banks' claims against SONACOS.

---

[3] The level of concentration in the Senegal banking sector is illustrated by the fact that the four largest banks account for almost 70 percent of deposits and loans. This is consistent with Herfindahl-Herschman Index data that suggests the level of concentration in Senegal in 1999 (0.15) was higher than in several other African countries—e.g., Ghana (0.13), Kenya (0.09 in 1997), and South Africa (0.14).

Table 2. Indicators of Banking Soudness in Senegal
(In percent)

CAMELS Indicators	1996	1997	1998	1999	2000
Capital Adequacy					
Total capital/risk-weighted assets (RWA) 1/					20.6
Total capital/ total assets	7.8	8.4	8.6	9.5	9.2
Assets					
Total loans/total assets	59.8	59.0	57.6	55.6	63.5
Loan concentration					
Five largest borrowers (gross) / total capital 2/	...	42.2	64.2	80.1	177.3
Sectoral distribution of bank credit					
Industrial (includes SONACOS)	21.0	20.2	22.2	29.6	31.3
Retail and wholesale trade	40.7	41.4	35.9	26.0	28.6
Services	11.5	12.6	14.3	16.4	14.9
Nonperforming loans					
NPLs (gross)/total loans	20.1	20.3	18.1	19.4	19.3
NPLs net of provisions/total loans	7.4	7.0	6.6	4.9	6.3
NPLs net of provisions/total capital	47.1	42.1	38.6	20.5	51.3
Management					
Noninterest expenses/revenues	54.9	46.0	40.9	43.3	44.8
Pre-tax earnings/employee (CFAF millions)	8.5	10.5	10.1	15.4	15.5
Earnings					
Pre-tax return/(average) assets	2.2	2.1	1.8	2.6	2.4
Pre-tax return/(average) equity	52.1	31.4	24.4	32.4	25.9
Interest margin/(average) assets	3.9	3.9	5.7	4.8	5.2
Noninterest expenses/(average) assets	3.3	2.9	3.3	3.0	3.2
Liquidity					
Liquid assets/total assets	33.3	34.1	35.7	35.9	28.4
Liquid assets/total deposits	38.9	39.5	41.8	44.4	34.9
Total deposits/ total liabilities	85.5	86.2	85.5	80.9	81.5
Sensitivity to market risk 3/					
Net non-Euro FX position / total capital	0.2	0.1	0.5	15.6	...
Net French franc FX position / total capital 4/	0.4	7.4	18.9	23.9	...

Source: Senegalese authorities.

1/ Risk-weighted capital adequacy calculations were introduced in 2000.
2/ Five largest borrowers include: SONACOS, SENELEC, SAR, ICS, and SODEFITEX.
3/ Sensitivity to interest rate risk not evaluated because with the exception of BHS, bank financial assets and liabilities are either tied to base lending rates or are repriced in one month or less.
4/ Net euro foreign exchange position beginning in 1998.

Credit risk and stress test

38. The banking system's exposure to SONACOS is a source of concern. As of April 30, 2001, total credit granted by the nine Senegalese-incorporated banks to SONACOS (i.e., all local banks except the one that is a branch of a large international bank) was the equivalent of 68.2 percent of these banks' capital, after deducting deposits provided by the Senegalese government to some of these banks to secure their loans.[4] All of these loans are

[4] The difference between current exposures (68.2 percent of locally incorporated bank capital) and the amount of capital impaired in the event of SONACOS' default (28.7 —Table 3) reflects (continued)

classified on bank financial statements as performing loans. Since the 1999–2000 groundnut crop financing was not repaid on time, the outstanding crop credits were converted into normal loans at higher interest rates, as per the terms of the loan agreements. Nonetheless, some banks have classified these exposures for internal purposes as nonperforming as per their internal rating systems, and in view of the fact that the BCEAO had not renewed the SONACOS rating approval agreement.

39. Loans to SENELEC are also a cause for concern due to its unclear viability and the arrears it is accumulating with local petroleum suppliers. As of April 2001, loans to SENELEC equated to 20 percent of total bank capital for the locally incorporated banks. If the banks' exposures to SENELEC's local petroleum suppliers (notably the SAR petroleum refinery) are included, the equivalent in terms of locally incorporated bank capital rises to 69.2 percent.[5]

40. Given the uncertainties surrounding SONACOS and SENELEC, the mission assessed the banks' abilities to absorb losses in the event these two institutions fail to honor their obligations. Four scenarios were considered: (1) default by SONACOS on its current obligations after taking into account expected export receipts in 2001 from sales of groundnut products; (2) default by SENELEC on its current obligations; (3) default by SENELEC combined with defaults by the petroleum companies; and (4) combined default by SONACOS, SENELEC, and SENELEC's local petroleum suppliers. These can be considered hypothetical worst-case scenarios, which do not take into account the possibility that the Senegalese government might step in to cover the losses of its parastatals.[6]

41. Table 3 summarizes the results of the stress tests. If SONACOS is not able to honor its obligations and the banks have to fully provision their net exposures, four of nine locally incorporated banks would require significant injections of new capital from their parents in order to respect the Banking Commission's 8 percent risk-weighted capital adequacy guideline, although no bank's capital would be fully impaired. A default by SENELEC would require 6 of 9 locally incorporated banks to seek new capital, but would fully impair the capital of these 6 banks if a default by SENELEC undermined the financial stability of its petroleum suppliers. Thus, the stability of the local banks is highly dependent on the financial condition of SONACOS and SENELEC, and these companies' abilities to honor their financial obligations.

---

assumptions regarding the amount of loans that could be repaid from sales of groundnut products in 2001.

[5] However, it should be noted that as of April 30, 2001, SENELEC's difficulties had not yet resulted in a major increase in borrowing by the energy sector.

[6] Ideally, the staff would have also liked to conduct stress tests of the vulnerability of the financial system to movements in prices of groundnuts and other key commodities. However, there were insufficient data available to conduct such an analysis. Moreover, these tests would have been undermined by the government's involvement in setting producer prices for groundnuts and prices for energy consumed locally.

Table 3. Credit Risk Stress Test Results 1/

	SONACOS Default 2/	SENELEC Default	SENELEC and Petroleum Sector Default	All Three Sectors Default
Capital fully impaired (no. of banks)	0 (0)	0 (0)	4 (21.3)	6 (53.7)
Capital < 8 percent risk-weight (no. of banks)	4 (49.9)	6 (53.7)	6 (53.7)	6 (53.7)

Source: BCEAO.

1/Numbers in brackets indicate share of these banks' capital as a percent of total locally incorporated bank capital.

2/Simulations are based on April 30, 2001 data.

Market risk and stress test

42. The market risks faced by banks operating in Senegal are relatively minor and can be grouped in four categories: liquidity or transformation risk (risk of not being able to honor commitments or meet withdrawals because assets are less liquid than liabilities); exchange rate risk (risk of losses owing to exchange rate movements); interest rate risk (risk that the value of assets and liabilities might be affected differently by changes in interest rates); and other forms of market risk, such as the direct effects on the banks' of movements in equity and commodity prices.

Liquidity/transformation risk

43. Although some speculation about the possibility of a devaluation of the CFA franc at the time of the transition to the euro in 1998 did not result in a decline in the volume of bank deposits, there was a significant flight of capital away from the Senegalese banking system (as well as from other CFA franc-zone member countries) prior to the 1994 CFA franc devaluation. Total deposits in the Senegalese banking system declined 20 percent (CFAF 34 billion) and currency in circulation outside the banking system by 13 percent (CFAF 14 billion) in 1993, before rebounding sharply following the devaluation.

44. To assess the capacity of the banks to withstand such a crisis of confidence, an estimate was made regarding the percentage of deposits that could be withdrawn without causing problems for the institutions. For the system as a whole, banks' liquid assets and holdings of government securities cover 34 percent of deposit and interbank liabilities. Indeed, the liquidity ratio ensures that banks would have more than enough readily available assets to meet a run of deposits similar to the one that occurred in 1993. As a result, the banks should have ample liquidity to manage their structural transformation risk and absorb unexpected deposit outflows. However, as the interbank market continues to develop and becomes more integrated across the WAEMU, it would be reasonable to expect that the excess liquidity currently present in Senegal could eventually become more efficiently distributed across the union. Thus, the authorities will

need to ensure that the banks' liquidity management practices continue to develop so that they will be able to manage their transformation risk prudently and effectively in such an environment.

Foreign exchange risk

45. The net positions of three banks in euro-linked currencies have grown in recent years relative to their capital. However, there is currently virtually no risk related to a hypothetical adjustment of the parity. Total net positions in other currencies are also growing, but are fairly small and mainly found at one bank; hence, they too do not constitute a major risk factor for any of the banks under any plausible set of assumptions regarding future exchange rate movements. Thus, the risk associated with exchange rates for banks operating in Senegal is primarily credit risk-related in that exchange rate movements may alter the financial condition of local borrowers, and spill over to the banks in the form of higher loan losses. The mission was unable to obtain sufficient data to assess the magnitude and importance of this type of risk.

Interest rate risk

46. Banks do not appear to actively manage their exposure to interest rate risk on a continuous basis, and the prudential ratios used by the Banking Commission do not directly address the management of this type of risk. For most banks this is not a cause for concern. With the exception of the housing bank, their interest-bearing assets have very short-term or variable interest rates, and most of their interest-bearing liabilities are repriced in one month or less. Hence, movements in interest rates would not, in and of themselves, trigger material losses for these institutions.

47. Even though some of its loans are based on floating interest rates and a portion of its deposit base is long-term in nature, the housing bank, Banque de l'Habitat du Senegal (BHS), has a major structural exposure to interest rate risk in that it grants very long-term fixed-rate mortgages to households (the term is typically the number of years before the borrower retires and thus can range up to 20 years), which are funded by floating-rate deposits and term deposits with maturities ranging up to four years. Officials at this bank appear to be fully conscious of the risks associated with such a mismatch, and have endeavored to extend the duration of their liabilities, for example by privately placing 5–7 year bonds with institutional investors. However, the embryonic state of capital markets in the WAEMU prevents them from being able to issue the long-term liabilities needed to fully eliminate this mismatch. This institution is highly underlevered, with a capital adequacy ratio in excess of 40 percent on a risk-weighted basis; thus, it should be able to cope with the direct effects of a major interest rate shock and still respect the Banking Commission's minimum capital adequacy ratio under any plausible interest rate scenario. In the future, the bank should consider changing the terms and conditions of future mortgage loans granted so that they can be repriced more frequently in line with its liabilities.

Other market risks

48. The banks do not have any material equity price risk, inasmuch as equity markets are at a nascent stage of development in the WAEMU region. Regarding commodity price risk, there is no information on the direct exposure of banks and other credit-granting institutions. However, exports and imports of a few commodities continue to play a significant role in the Senegalese economy suggesting bank clients are exposed to these price swings even if the banks are not.

Thus, for the banks exposure to commodity price risk—through its links to the credit risk of borrowers—is high, albeit probably less than would be the case for some other members of the WAEMU, since Senegal has a relatively well-developed service sector. It is worth noting that the collapse of commodity prices on world markets in the latter half of the 1980s contributed to some extent to the Senegalese banking crisis in the late 1980s to early 1990s.

B. Insurance Companies

49. The Senegalese insurance industry represents less than 10 percent of total financial system assets, and thus does not constitute a major source of systemic risk to the rest of the financial system. However, it does display several signs of vulnerability. The Senegalese insurance industry is stagnant, rather protected, with a large number of companies retaining too much risk, and engaging in poor diversification. Consolidation in the sector should be promoted and regulation amended to allow diversification of risk in foreign markets.

50. The major strength of the Senegalese insurance industry is represented by the CIMA (Conférence Interafricaine des Marchés Publics d'Assurance) code and the availability of financial information on individual companies. The Commission Régionale de Contrôle d'Assurance (CRCA) supervises the insurance industry for the region as a whole. Nonetheless, it relies on national Direction Nationale des Assurances (DNAs), located in the ministry of finance in Senegal's case, to conduct day-to-day supervision of insurance companies within each country. In Senegal, the DNA has hired five well-qualified staff members, but there are no actuaries, which limits the support it can provide to the CRCA. Hence, there is a need to ensure that services provided by the CRCA and the DNA in Senegal are coordinated, and that resources are used effectively.

51. The minimum capital requirement for insurance companies in the region is low. As a result, there have been a large number of applicants. The minimum capital requirement was recently increased to CFAF 500 million (CFAF 300 million for mutual companies), a figure the mission believes should be gradually increased to CFAF 1 billion (CFAF 600 million for mutual companies). However, this would have almost no impact on the companies in Senegal that own funds well above these values.

52. Principles of corporate governance and internal controls are not applied in Senegal. The mission recommended that Board of Directors be required to set investment policies and policies on conflicts of interest, and to establish formal internal controls that the supervisor should monitor.

53. The high retention of risk in Senegal originates from different causes. The maximum reinsurance rate of 50 percent allowed in the calculation of the solvency margin is the same as the one used in the European Union. However, it appears too low for the Senegalese market and it could lead to excessive risk retention. The mission recommends that it be increased to 70 percent provided regulations are in place to encourage reinsurance with reinsurers that are financially strong.

54. The limited use of reinsurance in Senegal raises concerns for the solvency of the industry. Especially because current reinsurers are not monitored and reserves cannot be diversified abroad because existing arrangements surrounding the convertibility of the CFA franc preclude investing offshore. Consequently, reserves should be allowed to be freely invested in the region

and, if possible, outside the region. Also, the CIMA Code does not foresee overall and/or individual risk exposure limits. Most countries impose retention limits similar to those held in addition to whatever capital adequacy regime they have. A widely used standard is to limit the maximum a company will retain on a single risk to 10 percent of its own funds.

C. Microfinance

55. Microfinance development in Senegal has kept pace with the dynamic evolution of the subsector in the WAEMU. In Senegal, the number of institutions (institutions de base) and their membership have reportedly grown to reach about 18 percent of the households, almost three times the 1995 coverage rate, and clearly higher than that of other countries in the continent. Deposit balances in MFIs have grown about five times as fast as those held in the banking system in recent years, thus increasing the relative importance of MFI deposits vis à vis bank deposits from the equivalent of 1 percent in 1996 to 2.4 percent as of June 2000.

56. While three types of MFIs coexist, the mutualiste savings and credit model largely dominates the market. Four of these institutions, out of about 30 included in the BCEAO-BIT data bank, account for more than 80 percent of the total membership. These larger institutions, with one exception, are organized as networks (réseaux) with well-established information systems, regular internal controls, and adequate liquidity management arrangements with commercial banks. Their recovery rates are reportedly above 95 percent, although their overall soundness is difficult to evaluate since key performance indicators are undisclosed.

57. Aside from the major MFIs, a large number of small entities are authorized to mobilize savings and make loans with small membership and weak institutional structures. Indeed, the rapid expansion of the sector and the apparent lag in establishing adequate monitoring mechanisms create two main sources of concern. First, the risk of excessive proliferation of weak institutions and subsequent failures involving the loss of savings for low-income households, and the impact these failures may have on the overall image of the MFI sector. Second, at the other end of the spectrum, is the concern voiced by the large institutions about the options available to consolidate and solidify their structures without necessarily becoming a bank.

Supervision capacity, a key constraint

58. The Assistance Technique aux Caisses Populaires d'Epqargne et de Crédit (AT/CPEC) unit at the Ministry of Economy and Finance is responsible for the supervision of MFIs. While a strict regulatory framework is not appropriate for MFIs, with a total of 12 employees, the unit's capacity to oversee close to 500 institutions appears inadequate.

59. Two recommendations were made: (a) strengthening the unit's capacity and providing a close monitoring of the licensing of new MFIs; and (b) evaluating the need to establish an appropriate supervisory body for MFIs. Concerted action among all the interested parties will be necessary.

Interest rate ceiling

60. While the interest rate ceiling of 27 percent, in practice, is not enforced, it encourages circumvention by the MFIs so as to help cover their operating costs, typically much higher than the margins implicit in the usury rate, particularly for small-scale MFIs.

D. Securities Markets

61. Securities market trading in the WAEMU takes places on a regional basis. Equities are traded in Abidjan at the Bourse Régionale des Valeurs Mobilières (BRVM), which was legally established in December 1996, and began operation in September 1998. The WAEMU securities market is therefore in its early phase of development.

62. Securities market trading in the WAEMU is quite limited. At end-December 2000, there were 41 shares listed at the exchange. Thirty-five of these were carried over from the former Abidjan stock exchange. The remaining six new shares correspond to public offerings made since the BRVM was created. Of these, four are from Cote d'Ivoire, one from Senegal, and one from Benin.

63. The bond market, however, has become increasingly active since the inception of the regional market. The total value of listed bonds has spiraled from CFAF 40 billion in September 1998 to CFAF 129 billion at the end of 2000. Currently, there are 17 bond issues listed, from 13 different issuers. These issuers range from national governments (which typically sell treasury bonds), to quasi-public regional development banks, to privately owned commercial banks and industrial companies.

64. The securities market faces several problems, including the weak observance of IOSCO principles (Section II). These weaknesses are the consequence of being a recently established market. The first issue affecting this market is its financial viability and sustainability. Since it is a relatively new component of the financial system, the securities market has not reached the volume of activity needed to cover its operating costs, including those of the supervisory system. Nor is the volume sufficient to enable the market intermediaries and the two central institutions (exchange and depository) to break even. In addition, owing to this low level of activity, intermediation costs are high, which further limit the market's liquidity. The regional body responsible for the regulation of this market (Conseil Regional) set regulations that are broadly in line with international practice. However, there are substantial deficiencies with respect to adequate resources and the capacity to perform its functions and powers. Also, the practical implementation of the ongoing supervision of the SROs is lacking and the Conseil has not yet established the full mechanism of supervision.

E. Pension System

65. The pension system in Senegal does not cause serious concerns of systemic risk to the rest of the financial sector. The reason being that very few links exist between the retirement schemes and the rest of the financial sector. FNR (Fonds National de Retraite) has no reserves, while IPRES (Institution de Prévoyance Retraite du Sénégal) had CFAF 35 billion in reserves in 2000, which represent only 5 percent of total financial assets (here approximated by M2) in the economy. These reserves are almost entirely placed in the banks and are expected to slowly decline, reflecting the changes in the demographic structure of the population covered. For

instance, a recent actuarial report by IPRES estimates that reserves will be reduced to zero by 2006/2007.

66. The current financial situation of the pension system may have an important fiscal impact in the future because of the explicit (in case of FNR) and implicit (in case of IPRES) government guarantees linked to the public nature of the service provided by these schemes. It is recommended that urgent parametric reforms be implemented to the FNR and IPRES plan to temporarily postpone the insolvency of these schemes. These reforms should give enough time to the Government to study a systemic pension reform aimed at funding pension liabilities.

IV. Infrastructure Supporting the Financial System

A. Legal System

67. Judicial organization in Senegal is governed by Decree 84–1194 of October 22, 1984 organizing the Judiciary. There are no commercial courts or sections specializing in commercial law in the tribunals and courts.

68. As for the enforcement of decisions, creditors who are not paid by their debtors may obtain the forced execution of instruments and judgments recognizing the existence of their rights. It seems, indeed, that numerous debtors demonstrate ill will with respect to paying their bank debts. However, forced execution is not an ideal system for creditors, as they are required to observe the rules of judicial enforcement if they do not wish to have their action declared null and void.

69. The functioning of justice in Senegal has traditionally been recognized as satisfactory. However, certain current trends are beginning to be worrisome. Although the Single Act on Simplified Procedures of Collection and Enforcement Means entered into force in the member states in 1998, and the associated simplified procedure should have been advantageous to creditors, in reality many Senegalese debtors seem to have systematically used certain channels of appeal associated with the sophisticated civil procedures law as delaying tactics, with a view to prolonging the procedures in a way that can be considered excessive. Such tactics can impede the ability of banks and other lenders to expeditiously foreclose on their collateral, which adds to the amount of credit risk in the financial system.

70. The modernization of the Senegalese justice has not followed the same pace of development as the financial system, and exhibits certain sluggishness. In addition, judicial infrastructures are extremely outmoded: there is little or no computer or consultative hardware, and most legal decisions are not systematically published. There are also real problems of availability, access, security, and safekeeping of the documentation that is supposed to be kept by the judicial system.

71. The functioning of justice is often criticized these days by the financial community, in particular certain banks, which express doubts about the competency of magistrates and the quality of their decisions. It seems that the capacity has not yet been developed to provide magistrates with continuing training in banking and financial law. To deal with this problem, a higher school for magistrates was recently established by the Organisation pour l'Harmonisation en Afrique du Droit des Affaires (OHADA). One of the expectations is that it will provide

magistrates with training in financial law. Currently, magistrates are not necessarily assigned on the basis of their specialization, something that will probably change with the availability of magistrates trained in banking and finance. Given the disadvantage of marring the image of a judicial system that has been generally deemed to be satisfactory on other points, measures should be taken to strengthen its credibility in the financial area. These include:

a. Consider the possibility of creating commercial courts or making courts specialized by creating commercial chambers with specialized magistrates.

b. Promote the use of arbitration and mediation in the banking sector, so as to limit lawsuits.

c. Intensify training for judges and court clerks in the area of commercial, banking, and financial law. Arrange to have judges assisted by clerks or junior court officers to facilitate their work.

d. Make arrangements to improve the infrastructures and resources of the courts and tribunals, as well as their maintenance (computerization, documentation, furniture, hearing rooms, office equipment, regular and timely publication and dissemination of legal decisions).

72. The Council of the Senegalese Bar has also requested banks to be more transparent regarding credit terms, in particular when the customer is not very educated or is unfamiliar with the banking system.

B. Liquidity Management and Interbank Market

73. Banking system liquidity management and, more generally, monetary policy are conducted on a regional basis by the BCEAO. As indicated in the Transparency Code assessment (Section II), the BCEAO largely observes the main principles. The pegged exchange rate arrangement limits monetary policy flexibility. However, given that international capital flows are limited, there is some scope for pursuing an independent monetary policy, aimed at maintaining inflation on par with that prevailing in the European Monetary Union. To this end, the BCEAO influences the evolution of total liquidity circulating in the region mainly with the help of two monetary instruments: reserve requirements and standing facilities, and on occasion with some open market operations. In addition, the BCEAO charter specifies that central bank advances to Governments must not exceed 20 percent of the previous year's fiscal revenue. At end-1998, the WAEMU Council of Ministers decided to freeze the cap on those advances at the level reached in December 1998 and to take steps to eliminate them by end-2001. Beginning in 2002, government securities with maturities between seven days and two years will be issued to finance government requirements.

74. Since its inception, the BCEAO has generally met its monetary objectives, and no liquidity crises have arisen. In the early 1990s, the BCEAO's intervention instruments were modified and adapted as part of the move from direct to indirect monetary management, and an interbank money market was introduced. Notwithstanding the success of the monetary union, there is little regional interbank market activity. Studies are under way to fully develop the region's capital markets and foster interbank market activities.

75. Reserve requirement is the instrument used, at times, at the initiative of the BCEAO to manage a country's liquidity. Reserve requirements differ across BCEAO countries. In Senegal, the reserve ratio was raised from 3 percent to 9 percent in August 2000. The ability to set different reserve ratios in the various WAEMU member states without triggering intra-regional flows of deposits or loans, is evidence that monetary integration in the Union remains limited. Another feature of the WAEMU reserve requirements system is that assessments are made on both the short-term liabilities and short-term assets of banking institutions. Reserve requirements on short-term loans are used by the BCEAO to control the growth of these loans compared to other assets and to facilitate the transition from the old system of credit controls to the current one based on market forces.[7]

76. Following the introduction of government securities by member countries in 2002, the authorities should consider using open market operations more frequently to adjust domestic liquidity in Senegal. To the extent that the transition to indirect instruments has been successful and within the framework of increased development of the money market, reserve requirements should be eliminated with respect to assets and maintained only against deposits once that active open market operations are introduced to manage banks' liquidity. The announced close cooperation between the BCEAO and the Ministry of Finance in the area of debt issuance was welcomed and strongly supported. The recently approved IMF/World Bank Guidelines for Public Debt Management should assist the authorities in this area.

Interbank market

77. Although the relevant framework and procedures are in place, the interbank market is not very developed, in particular for transactions across member states of the Union. With the introduction of government securities in 2002, the BCEAO was strongly encouraged to continue its efforts to foster the development of a collateralized regional interbank market. This should facilitate capital flows within the monetary union and correct the liquidity disparity between member countries. This would also help the authorities to apply reserve requirements at the same rate for all countries.

C. Payment System

78. Senegal's payment system is at an early stage of development and fails to meet the needs of a modern economy and an active interbank market. The chief weaknesses have been clearly identified by the BCEAO for the Union as a whole and for each member country. The BCEAO has launched a reform of payment systems at the regional level, with financial and technical assistance from the World Bank, which should result in the implementation of a system consistent with recommended international standards for risk and efficiency. Inter alia, the legal

---

[7] The authorities indicated that this reserve requirement is an effective instrument to limit credit expansion in Senegal. The disadvantage of such a requirement is that it slows the effect of a decline in deposits (and thus of a downturn in business) on the banking system, and thereby eventually creates some difficulties. One is that banks cannot rapidly adjust their lending, not even their short-term loans, and are required to continue constituting reserves even when their resources have dwindled. In normal situations, it also discourages credit expansion to the private sector.

framework needs to be strengthened—particularly with regards to modernizing payment instruments and the underlying rules and procedures governing settlement. However, the current manual system does not present any systemic risks, since BCEAO staff closely monitor its operations at the source when large transactions and transfers are undertaken among participants of system and with other WAEMU countries or foreign countries.

79. The current payment system is slow and inefficient. As a result, most monetary transactions are conducted using cash, since less than 9 percent of the Senegalese working population has a bank account (compared to 18 percent who are members of MFIs). Exchanges of securities within clearing houses are handled manually, and checks and payment items are physically exchanged on-site at local and national clearing agencies. Delays in crediting customers' current accounts (following clearing) stand at three days locally, but may exceed two weeks when the clearing process takes place in a financial center apart from the one in which the payment was initiated.

80. The inefficiency of the current payment system is one of the reasons why the WAEMU interbank market is very thin, and helps to explain why banks refinance a significant portion of their funding requirements through the BCEAO by mobilizing their holdings of government securities or private securities authorized by the BCEAO.

Reform of the payment system

81. With a view to correcting the weaknesses mentioned above, the BCEAO, with financial and technical assistance from the World Bank, has launched a project to reform the payment system of the members of the Union, including Senegal's. Preliminary studies were completed in 1999 and 2000; World Bank funding was provided to the BCEAO in October 2000; and invitations to bid for the provision of interbank clearing and settlement systems are currently being prepared. The project, which is expected to be completed in 2002, is expected to provide the Union with a modern payment system permitting: (1) a real-time gross settlement for large transaction; (2) automated settlement through the creation of national clearing houses, and electronic settlement systems for low-value transactions; (3) a shift from paper-based clearings to rapid electronic settlement; (4) the assurance of rapid finality of settlement for securities transactions; and (5) the development of transactions using bank cards via interbank networks and acceptance of a common product. There is every expectation that the new payment system will conform to international standards.

SECTION II—FINANCIAL SECTOR ROSC MODULES

This section contains information on adherence to and consistency with major international standards and codes relevant for the financial sector. The assessment has helped to identify the extent to which the supervisory and regulatory framework has been adequate to address the potential risks in the financial system. It has also provided a source of good practices in financial regulation and supervision in various areas.

Detailed assessments of standards were undertaken based on a peer review process, as part of the Financial Sector Assessment Program (FSAP), by Luc Cardinal (World Bank) and Marcel Maes (Consultant, Belgium Commission Bancaire et Financiere (retired) for the preliminary assessment of the *Basel Core Principles for Effective Banking Supervision*; Andres Jaime (World Bank) and Brian Gelfand (IOSCO) for the *International Organization of Securities Commissions' Objectives and Principles of Securities Regulations*; and Christine Sampic (IMF) for the IMF's *Code of Good Practices on Transparency in Monetary and Financial Policies*. The expert team prepared detailed assessments by drawing on information provided by the Senegalese authorities, including self-assessments, and on fieldwork during November 2000 and January 2001. This section contains a summarized version of the assessments included in the FSAP report.

Since Senegal is a member of the WAEMU region, monetary policy and financial sector supervision are conducted for the region as a whole by regional institutions. Therefore, the assessments made in the context of Senegal apply for the region as a whole.

The assessments confirm that notable, albeit uneven, progress has been made by the WAEMU in introducing international standards. According to a preliminary assessment, considerable progress has been made by the Banking Commission to comply with most of the Basel Core Principles for Effective Banking Supervision and efforts are under way to achieve full compliance, in particular in the money laundering area. However, several weaknesses were identified (Appendix I). The shortcomings in the observance of several IOSCO principles indicate weakness in the area of secondary market supervision, prudential regulations and intermediation, risk management and exchange of information (or coordination with other regulators). Overall, there will be a need in the future for some coordination among all the regional supervisory bodies. The payment system is undergoing reform, thus no assessment was made, since a new payment system, which should observe most of the CPSS Core Principles, is expected to be introduced in 2002. Finally, transparency practices relating to monetary policy with reference to the IMF Code of Good Practices on Transparency in Monetary Policies is satisfactory.

V. Compliance with the Basel Core Principles for Effective Banking Supervision

82. A preliminary assessment was made during this mission and some of the main findings are summarized in Appendix I. A final assessment is expected to be made in the context of the forthcoming FSAP mission to Côte d'Ivoire.

VI. Observance of IAIS Insurance Supervisory Principles

83. An initial assessment for the region as a whole was made in the context of the Cameroon FSAP, and the assessment is contained in the Board paper FO/Dis/00/66. An update of the assessment is being conducted in the context of the FSAP mission to Gabon.

VII. Observance of IOSCO Objectives and Principles of Securities Regulation

General

84. This assessment covers the WAEMU securities sector, for which regulation and supervision are largely the responsibility of the Conseil Régional de l'Epargne Publique et des Marchés Financiers (CREPMF). The main objectives of the assessment are to determine levels of observance with the International Organization of Securities Commissions (IOSCO) Objectives and Principles of Securities Regulation, and to suggest areas where further development may be appropriate. The assessment of securities regulation for the WAEMU market was performed in January/February 2001 as part of the FSAP assessment for Senegal, but its findings apply to the region as a whole.

85. The assessment is based on a review of the WAEMU securities laws and regulations, the CREPMF Annual Report, market information from the stock exchange and other market intermediaries, and extensive discussions with the staff of the CREMPF. In addition, meetings with the stock exchange, the central depository/clearing and settlement bank, market intermediaries, issuers and investors also provided valuable input to the assessment.

Institutional and macroprudential setting, market structure—Overview

Supervisory framework

86. The regulator of securities markets in the WAEMU is the Conseil Régional de l'Epargne Publique et des Marchés Financiers ("Conseil Régional," or "Conseil") created by the Convention Portant Création du Conseil Régional de L'Epargne Publique et des Marchés Financiers, an agreement among the member States of the WAEMU. The composition, organization, functions and powers of the Conseil Régional are set forth in the Annexe Portant Composition, Organisation, Fonctionnement et Attributions du Conseil Régional de L'Epargne Publique et des Marchés Financiers (the "Annexe"). The Conseil des Ministres of the WAEMU has adopted, and has the power to modify Regulations to specify the practical implementation of the powers of the Conseil Régional ("the Regulations").

87. The Conseil Régional is charged with the responsibility to organize and supervise public offerings of both debt and equity securities, and to authorize and supervise market structures (bourses and clearing and settlement systems) and market intermediaries. The Conseil des Ministres can modify the Regulations, and the Conseil Régional can interpret the Regulations through the publication of Instructions.

88. The CREPMF is the central regulatory body of the securities market. It has the mandate of protecting investors in securities and any other similar instrument marketed through a public offering in the countries that are part of WAEMU. To accomplish this objective, it is the institution designated to regulate and authorize, through the issuance of a visa, the processes of public offerings of securities, irrespective of whether the securities are listed in an exchange or not; and to license and control all market structures and intermediaries.

Market structure

89. The regional stock exchange (BVRM) in Abidjan is the main component of the WAEMU capital market and handles trading in equity and debt securities in the region. The market is supported by the regional depository, the Dépositaire Central/Banque de Règlement (DC/BR). Over-the-counter trading of securities does not take place. There are 15 broker-dealers, most of which are subsidiaries of banks. SGPs (investment counselors) and investment promotors also operate in the market.

General preconditions for effective securities regulation

90. The three core objectives of securities regulation are the protection of investors; ensuring that markets are fair, efficient and transparent; and the reduction of systemic risk.

91. These objectives are closely related and, in some respects, overlap. Many of the requirements that help to ensure fair, efficient, and transparent markets also provide investor protection and help to reduce systemic risk. Similarly, many of the measures that reduce systemic risk provide protection for investors.

92. Further, matters such as thorough surveillance and compliance programs, effective enforcement and close cooperation with other regulators are necessary to give effect to all three objectives.

Main findings

93. The responsibilities of the regulator, as well as procedures for appointment, terms of office and removal of members of the governing body of the regulator are clearly specified in the Regulations. These regulations also provide for protection of regulators and their staff acting in the bona fide discharge of their functions and powers. However, they do not provide for strong cooperation among domestic regulatory authorities, and apparently there is little formal communication or cooperation between the Conseil Régional and other relevant regulatory authorities, such as the regulator of the banking sector in the WAEMU. The only form of public accountability of the Conseil is the requirement to publish an annual report. Decisions of the

Conseil are not published and there is no requirement in the law or regulations that decisions be supported by written reasons.

94. The Conseil is granted wide powers for the authorization and supervision of market structures and market intermediaries, and the authorization and supervision of public offerings of debt and equity instruments. The extent of these powers seem to be adequate. However, there appear to be substantial deficiencies with respect to adequate resources and the capacity to perform its functions and exercise its powers.

95. In terms of transparency, there is no provision, or requirement, for the Council of Ministers to consult with the public in making or modifying the Regulations. Also, there are no provisions, or requirements, for consultation when the Conseil prepares Instructions, but the Secretariat does consult with the exchange and market intermediaries on an informal basis.

96. The Regulations provide that the Conseil Régional supervises the activity of the SROs. The statutory and regulatory requirements implement the relevant IOSCO Principles. However, the practical implementation of the ongoing supervision of the SROs is lacking. The Conseil has not yet established the mechanisms to supervise the Bourse and the DC/BR, or their operations.

97. The Conseil is granted wide powers to inspect, investigate and conduct surveillance of market activities. The Conseil also controls the activity of all market participants. Although the Conseil has sufficient powers of inspection, investigation, and surveillance, it is not equipped with sufficient resources and expertise to fully implement these powers. Perhaps the most glaring absence is the lack of market surveillance to detect unfair practices, market manipulation, or insider trading.

98. The Conseil can also verify issuers' respect of their obligations in a public offer. It is empowered to conduct both off-site and on-site supervision of authorized market intermediaries, but neither the Bourse nor the DC/BR have yet been inspected; nor is there any framework for their inspection. No investigations of market participants have been conducted either.

99. The Conseil has joined IOSCO and has signed two technical cooperation agreements, but to our knowledge, no information sharing or enforcement agreements have been established with any domestic or foreign counterparts.

100. The Conseil has the authority to authorize and supervise collective investment schemes (Organismes de Placement Collectif en Valeurs Mobilières, or "OPCVMs"). The main areas that remain to be implemented are: rules and procedures for ongoing supervision, prudential rules, and the addition of some provisions addressing potential conflicts of interest between the interests of investors in the scheme and those of scheme operators or their associates.

101. There are clear minimum standards for the authorization of market intermediaries, with requirements varying according to their activities. However, there is no general "fit and proper" requirement.

102. Market intermediaries are required to meet initial and ongoing capital requirements. These are set at a flat rate, and do not reflect any underlying risk. The regulations indicate that prudential rules setting out solvency and liquidity requirements will be issued in an Instruction.

There are currently no prudential requirements for market intermediaries and, therefore, capital requirements do not reflect the risks of the business, off balance sheet transactions, or activities of affiliated companies. The General Secretariat has indicated that these rules are in preparation.

103. The Conseil is given exclusive authority to authorize and supervise market structures, notably the Bourse and the DC/BR. However, the Conseil has no real-time access to market information, and does not review trading logs, although the General Secretariat stated that this will be implemented shortly. The Bourse conducts surveillance of trading, mainly to ensure orderly trading and the respect for its own rules. There is no organized, methodical detection and control of market manipulation, insider trading, or other unfair market practices. In summary, while the Regulations authorize the Conseil to supervise the operations of the market, and the Instructions require the Conseil to have real time access to all market information, no actual oversight takes place.

104. Finally, in terms of systems for clearing and settlement of securities transactions, the DC/BR has implemented procedures that appear to be designed to ensure that they are fair, effective and efficient and that they reduce systemic risk. However, there is little supervision of the operation of the DC/BR. The DC/BR files an annual report with the Conseil, and provides a quarterly report of the balance in the Guarantee Fund. The Conseil does not monitor the clearing and settlement system, nor has it carried out an inspection of it. Table 4 summarizes the observance with the principles of securities regulation.

Table 4. Summary of Main Findings of Assessment of Implementation of the IOSCO Objectives and Principles of Securities Regulation

Subject	Main Findings
Principles relating to the regulator, (CPs 1–5)	The responsibilities of the regulator, as well as procedures for appointment, terms of office and removal of members of the governing body of the regulator are clearly specified in the Regulations. These regulations also provide for protection of regulators and their staff acting in the bona fide discharge of their functions and powers. However, they do not provide for strong cooperation among domestic regulatory authorities, and apparently there is little formal communication or cooperation between the Conseil Regional and other relevant regulatory authorities, such as the regulator of the banking sector in the WAEMU. The Regulations provide for the independence of the Conseil from external, political or commercial interference in the exercise of its powers. There is also an instance of judicial review of the decisions of the regulator. However, the only form of public accountability of the Conseil is the requirement to publish an annual report. Decisions of the Conseil are not published, and there is no requirement in the law or regulations that decisions be supported by written reasons. The Conseil is granted wide powers for the authorization and supervision of market structures and market intermediaries, and the authorization and supervision of public offerings of debt and equity instruments. The extent of these powers seems to be adequate. However, there appear to be substantial deficiencies with respect to adequate resources and the capacity to perform its functions and exercise its powers.
Principles of self-regulation (CPs 6–7)	The statutory and regulatory requirements implement the relevant IOSCO Principles. However, the practical implementation of the ongoing supervision of the SROs is lacking. The Conseil has not yet established the mechanisms to supervise the Bourse and the DC/BR, or their operations.

Subject	Main Findings
Principles for the enforcement of securities regulation (CPs 8–10)	The Conseil is granted wide powers to inspect, investigate and conduct surveillance of market activities. It can also verify issuers' respect of their obligations in a public offering. The Conseil is empowered to conduct both off-site and on-site supervision of authorized market intermediaries. Although the Regulations grant it sufficient powers of inspection, investigation, and surveillance, the Conseil is not equipped with sufficient resources and expertise to fully implement these powers, and the Bourse only engages in very limited market surveillance.
Principles for cooperation in regulation (CPs 11-13)	The Regulations permit the conclusion of reciprocal information sharing and cooperation agreements with foreign financial market regulators. However, this is not the case for domestic regulators, for example, banking or insurance supervisors. This is of particular concern because of the significant number of market intermediaries that are subsidiaries of banks.
Principles for issuers (CPs 14–16)	The framework of securities regulation requires disclosure of financial results and other information on both an initial and ongoing basis. Basic protection measures are in place for minority shareholders. Some further measures, such as dissenter's rights of appraisal, mandatory cash buyouts, and rights of the minority shareholders to appoint an auditor, would improve protection of minority shareholders.
Principles for collective investment schemes (CPs 17–20)	The regulatory framework sets out clear requirements for the authorization of collective investment schemes. The main areas that remain to be implemented are: rules and procedures for ongoing supervision, prudential rules, and the addition of some provisions addressing potential conflicts of interest between the interests of investors in the scheme and those of scheme operators or their associates.
Principles for market intermediaries (CPs 21–24)	There are clear minimum standards for the authorization of market intermediaries, with requirements varying according to their activities. One area in which implementation could be strengthened is that of the qualification of staff. There are currently no courses or examinations for the licensing of staff. Market intermediaries are required to meet initial and ongoing capital requirements. These are set at a flat rate, and do not reflect any underlying risk. There are currently no prudential requirements for market intermediaries and, therefore, capital requirements do not reflect the risks of the business, off-balance sheet transactions, or activities of affiliated companies. The General Secretariat has indicated that these rules are in preparation.
Principles for the secondary market (CPs 25–30)	The Conseil is given exclusive authority to authorize and supervise market structures, notably the Bourse and the DC/BR. General criteria for the authorization of the Bourse and the DC/BR are contained in the Regulations, while Instructions stipulate the specific relevant provisions. There is no organized, methodical detection, and control of market manipulation, insider trading, or other unfair market practices. In summary, while the Regulations authorize the Conseil to supervise the operations of the market, and the Instructions require the Conseil to have real time access to all market information, no actual oversight takes place. In terms of systems for clearing and settlement of securities transactions, the DC/BR has implemented procedures that appear to be designed to ensure that they are fair, effective, and efficient and that they reduce systemic risk.

Recommended next steps and authorities' response

105. The substantial deficiencies with respect to adequate resoures and the capacity to perform functions and exercise powers could be addressed by further delegating powers from the Conseil Regional to either a full-time president, or alternatively, to the Secretary General. Also, since

neither the Conseil nor the Secretariat staff appears to have sufficient knowledge of or experience in securities markets, experts should be recruited and further training provided to Secretariat staff.

106. The Conseil needs to introduce mechanisms to supervise the Bourse, the DC/BR, and their operations. The BVRM should introduce market surveillance to detect unfair practices, market manipulation, and insider trading.

107. The securities industry should introduce reciprocal information sharing agreements with the regional banking and insurance supervisors, given the number of market intermediaries that are subsidiaries of banks.

108. Further measures to protect minority shareholders could be introduced, including: dissenter's right of appraisal, mandating cash buyouts, rights of minority shareholders to appoint an auditor, derivative actions, and rights of shareholders to require an extraordinary general meeting of shareholders.

109. Staff qualification requirements for market intermediaries could be introduced, such as courses or examinations for the licensing of staff. In addition, the authorities' intention to prepare rules governing the prudential standing of market intermediaries were welcomed.

110. The Conseil's supervisory capacity would benefit from having real-time access to market information and systems to analyze trading logs. In addition, the Conseil should monitor further the performance of the clearing and settlement system.

111. The assessment was presented to the authorities, but they have not provided any comments.

VIII. Observance of the Code of Good Practices on Transparency in Monetary and Financial Policies

General

112. This assessment is based on: (i) discussions with various departments of the BCEAO; (ii) a review of questionnaires on the IMF Code of Good Practices on Transparency in Monetary and Financial Policies (MFP) submitted by the BCEAO; (iii) a review of the main laws and regulations governing the BCEAO's activities; and (iv) a review of the BCEAO's internet website and its regular publications. In addition, discussions were held with other financial sector participants including officials and staff of commercial banks. This assessment was made in the context of the FSAP mission to Senegal, but its findings apply to all BCEAO countries, since the BCEAO operates on a regional basis.[8]

[8] The assessment was only prepared for the conduct of monetary policy.

Legal framework, institutions, and market structure—Overview

113. The objectives and the institutional framework of monetary policy are clearly defined in the Treaty establishing the WAMU, signed on May 12, 1962, and revised on November 14, 1973, as well as in the Statutes of the BCEAO attached to the Treaty. Matters relating to monetary policy are also included in the cooperation agreement between the French Republic and the Member Republics of the WAMU and in the Operations Accounts Convention, concluded on December 4, 1973. However, the direction of policy was changed in 1989 when the objectives initially defined to support economic development in the region ceased to be the top priority (see the WAMU document titled: La nouvelle politique de la monnaie et du crédit de la BCEAO [The BCEAO's new monetary and credit policy], October 1989). This document is not on the BCEAO website.

114. Monetary policy is conducted at the regional level. Article 1 of the WAMU Treaty establishes a common currency and a regional Central Bank. Article 12 of this Treaty gives the Council of Ministers of the Union responsibility for monetary policy to be implemented by the BCEAO. The Council of Ministers also has the authority to change the parity of the regional currency.

115. Monetary policy is mainly determined by the fixed exchange regime. The main objective of monetary policy is price stability, to be achieved by preserving the external value of the currency (that is, to maintain the fixed parity with the euro), thanks to an appropriate coverage of the money supply by foreign exchange reserves along the lines of the cooperation agreements with the French Republic. Sales of CFA francs against foreign exchange are permissible when they are for commercial transactions, and the BCEAO centralizes holdings of all foreign exchange in the Union.[9] Since 1996, annual inflation targets have been set by the Council of Ministers of the Union at the end of each year for the following year, and they were first published in December 2000.

116. To reach these targets, the BCEAO uses two instruments to influence overall liquidity in the economy: required reserves and the reference rates. Since the early 1990s, in tandem with the rehabilitation of the banking system and the devaluation of the currency, the BCEAO's intervention instruments were modified as part of the shift from direct to indirect monetary management, and an interbank market was established. The BCEAO's instruments and the ways in which they are used are described in regulations sent to the banks.

117. Article 16 of the Statutes provides that the total amount of resources granted by BCEAO to any one-member state may not exceed an amount equal to 20 percent of that country's tax receipts in the previous fiscal year. At end-1998, the WAMU Council of Ministers decided to

---

[9] Banks may engage in foreign exchange operations on their own or on their customers' behalf, through their foreign correspondents. However, operations to cover their negative balances with these same correspondents must go through the BCEAO, in so far as they involve the sale of CFA francs against foreign exchange.

freeze the ceiling on statutory advances at the December 1998 level and to endeavor to eliminate them by end-2001.

118. The responsibilities of the states and the central bank in the following areas are clearly defined in Articles 29–36 of the Statutes: public treasury bookkeeping; management of treasury bills; foreign financial operations; domestic and foreign public debt management; conclusion and execution of international financial agreements; changes in the legal framework for the currency; and operations of the WAMU.

119. The general procedures whereby the BCEAO reports on its conduct of monetary policy are governed by Articles 69 and 70 of its Statutes. Any changes in monetary policy (changes in reference rates, or in the required reserve ratio, for example) are normally immediately made public via press communiqués. The texts of these communiqués usually provide a general explanation of the change announced and are becoming more and more detailed overtime.

120. The BCEAO publishes a statistical bulletin every month, and one each quarter, which includes an analysis outlining the implications of economic developments for the monetary situation and any likely impact on monetary policy targets. The publication lag of this survey is a minimum of three months.

121. Apart from one meeting early in the year, meetings with bankers are organized sporadically to announce changes in monetary policy (raising reference rates, or changing the base for the reserve requirement, for example). On the other hand, there are no regular meetings for the BCEAO to report on the latest monetary developments and obtain bankers' feedback.

122. The central bank publishes on a fairly regular basis an information series on monetary policy, the economic and monetary situations of the member states, and its accounts. The lag for sending monetary data to the Statistics department of the IMF, for publication in International Financial Statistics has been reduced from six months to three months. Senegal has not subscribed to IMF's Special Data Dissemination Standard, but intends to participate in the IMF's General Data Dissemination System (GDDS) in the months to come.

123. At the end of each week, the BCEAO reports its interventions on the money market (calls for bids, issuance of securities), if any take place. Every month, with a lag of at least three months, it publishes Information and Statistics Notices, which systematically present regional and national statistics on monetary situations, conditions of central bank interventions, rates used by banks, and stock market developments. These statistics are sometimes accompanied by explanations of monetary policy developments (economic climate, monetary aggregates, and central bank interventions), as well as studies on specific subjects. They are not posted on the website. Press communiqués on the meetings of the BCEAO Board of Directors and the WAMU Council of Ministers are circulated immediately after the meetings. However, the report of discussions is not communicated to the public.

124. The BCEAO annual report, as well as the Governor's report on the economic, monetary, and financial situation of member states, are fairly widely circulated about nine months after the end of the fiscal year.

125. The BCEAO created a communications directorate in August 1998 to provide a continuous information service to the public. It also set up a website, which contains information on the announcements regarding monetary policy measures, its founding legal instruments, publications, and statistics.

126. Article 70 of the BCEAO Statutes requires the Governor to submit an annual report on developments in the monetary situation of the Union and on the operations of the BCEAO to the Board of Directors of the Bank, as well as to the Council of Ministers and to the Heads of State of the Member States of the Union. Although not statutorily required to do so, the Governor also reports annually on the monetary situation to the WAMU Interparliamentary Commission.

127. The central bank is also required by Article 69 of its Statutes to prepare a monthly statement of its accounts. They must be published in the Bulletin officiel [official gazette] of each Member State.

128. The BCEAO also publishes its financial statements approved by its Board of Directors, with a lag of six months after the end of the fiscal year (Article 63 of the Statutes). These statements are audited in each country by national accountants, appointed by the Minister of Finance, and at the regional level by a Superintendent Auditor (*Commissaire Contrôleur*) appointed by the Council of Ministers of the Union (Article 64), in charge of centralizing the comments of the national auditors and of auditing the centralized accounts.

129. The profits of the BCEAO are published in the official gazettes of the Member States of the Union. The procedures for their distribution are defined in the BCEAO Statutes, but the distribution of profits is not published: this is the responsibility of the Council of Ministers. The amount of BCEAO capital is published and its distribution among member states is given in the Statutes, which also detail the procedures for covering any losses and for constituting the reserves required to consolidate its equity capital.

130. Article 47 of the Statutes provides that central bank staff is bound by professional secrecy. Article 48 provides that they may not take or accept any participation or remuneration whatsoever, by working for or advising any private or public enterprise, without a special exception being granted by the Governor. BCEAO staff is governed by special staff regulations, albeit unpublished ones.

Main findings

131. The transparency of monetary policy in the WAMU is overall satisfactory. Table 5 summarizes the main findings of the assessment of Observance of the MFP Transparency Code. Since the creation of the Union in 1973, its governing legislation instruments have spelled out the main objectives and the framework for implementing monetary policy so that all member states have a clear vision of the general strategies adopted in this area. Operating as a monetary union presupposes a high degree of institutional transparency. Relations between the BCEAO and the member states have accordingly been clearly stated.

Table 5. Summary of Main Findings of the Assessment of Observance of MFP Transparency Code—Monetary Policy

Subject	Main Findings
I. Clarity of roles, responsibilities and objectives of central banks for monetary policy	The objectives, the institutional framework, the link between monetary and fiscal operations, as well as the other roles of the central bank are defined in the BCEAO statutes and in the international treaties governing the WAMU. However, the focus of policy was changed in 1989 from the objectives originally set forth, without any change to the legal texts.
II. Open process for formulating and reporting monetary policy decisions	The institutional infrastructure for communicating monetary policy provides for some degree of transparency, recently augmented by the creation of a website. At the same time, communication between the BCEAO and financial sector participants could be strengthened.
III. Public availability of information on monetary policy	The central bank fairly regularly publishes an information series on monetary policy, the economic and monetary situation of member states, and its own accounts. It has created a website, which it is increasingly providing additional information. Senegal has not subscribed to SDDS or contributed to GDDS yet, but it intends to participate in GDDS in the months to come. Neither monetary data, nor official publications have been posted on the website yet.
IV. Accountability and assurance of integrity by the central bank	The Governor reports to the Board of Directors of the Bank, as well as to the Council of Ministers and Heads of State of the Members of the Union. He presents an overview of the monetary survey to the WAMU Interparliamentary Commission. The BCEAO operating account and its financial statements, duly certified by external auditors, are published annually, with a six-month lag.

132. Over the last several years, the BCEAO has endeavored to enhance the clarity of its monetary policy and to provide the public with better information about its mission, objectives, main activities, and decisions. It has officially embraced the principles contained in the Code of Good Practices on Transparency in Monetary and Financial Policies. In June 1998, it also inaugurated a website that is regularly updated. This site currently contains the founding texts (WAMU Treaty and BCEAO Statutes), a summary of the monetary policy framework, interviews with the Governor, the latest press communiqués, as well as information on central bank interest rates and the rates posted by the commercial banks. In addition, Senegal intends to participate in the IMF's General Data Dissemination System (GDDS) in the months to come.

Recommended next steps and authorities' response

133. According to commercial bank officials, the transparency process could be further enhanced by increasing the frequency of consultation with financial sector participants to provide them with an analysis of the monetary situation, outline the conduct of monetary policy, and obtain their feedback. The mission believes that the transparency process would benefit from posting monetary data on the BCEAO's website, periodically and at short intervals. Increased coordination with the Minister of Finance, with the prospect of new government securities being issued, is welcomed. Finally, it would be desirable to participate in GDDS as soon as possible.

134. The BCEAO and the Ministry of Finance gave their comments to the mission in January and July 2001. Most of these comments have been taken into account in this paper. The BCEAO officials noted that meetings between the representatives of the commercial banks and the National Director are held on a regular basis (about three times a year), and bilateral meetings are organized upon demand. The governor meets once a year with all of the regional bankers' associations.

SENEGAL: SUMMARY OF PRELIMINARY FINDINGS OF ASSESSMENT OF IMPLEMENTATION OF THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION[10]

CPs Main Categories	Main Findings
Objectives, Autonomy, Powers, and Resources (CP 1)	Budgetary decisions are taken outside of the Banking Commission, which is responsible for prudential supervision. While the Banking Commission is authorized to take appropriate measures to deal with problems and violations, the notification procedure could potentially reduce the effectiveness of prudential actions. There are not any formal agreements with other supervisory authorities of the financial system except France.
Licensing and Structure (CPs 2–5)	The Banking Commission is paying increasing attention to corporate governance issues. In April 2001, it sent a circular-letter to banks outlining new measures to improve corporate governance and risk management.
Prudential Regulations and Requirements (CPs 6–15)	Substantial progress has been made with issuance of prudential rules containing new minimum capital adequacy standards. Credit institutions have until January 1, 2002, to bring themselves into line with these. A Banking Commission circular on corporate governance introduces mandatory capital adequacy and risk ratios on a consolidated basis. However, as the Banking Commission statutes do now allow for such measures, the Council of Ministers will have to issue adequate and legally binding rules to that effect. Risk concentration limits are too high and should be reduced gradually. Existing prudential forbearance in this domain should also be curtailed. Senegal has no legislation or specific regulations against laundering of the proceeds of crime, other than the law to combat drug trafficking. A working group (BCEAO and FATF) is in the process of preparing a regional legislation to be adopted by 2002.
Methods of Ongoing Supervision (CPs16–20)	There is room for improvement in provisions for on-site and off-site supervision: • Concerning off-site supervision, the move toward the automatizing of the transmission and processing of data received by banks was welcomed, but electronic transmission only encompasses the accounting data and not the prudential ones, which are still collected on paper forms. • For on-site inspections, it is regrettable that the number of staff assigned to on-site inspections declined from 27 in 1998 to 20 in 2000. The authorities noted that expected resources for 2001 would allow the Commission to conduct on-site inspections of banks in the regions every three years, compared with the every-other-year time span up to now. A strategic human resources plan should be developed to allow inspections every two years.
Information Requirements (CP 21)	The circulars and prudential rules provide guidelines covering all main elements. There is no directive on trading and other securities activities, or on derivatives or asset securitizations.
Formal Powers of Supervisors (CP 22)	Some credit institutions persist in repeated, contraventions of legislation and regulations. Moreover, some important credit institutions have been placed under close surveillance by the Banking Commission. Prudential forbearance should be adequately sanctioned and curtailed.
Cross-border Banking (CPs 23–25)	Procedures and a system specifically for supervising the activities of banking institutions operating outside the WAEMU member states are needed. Substantial progress has been made in developing an agreement with French banking supervisors.

[10] These preliminary findings are subject to further revision.