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Cameroon: Financial System Stability Assessment—Update

This update to the Financial System Stability Assessment on Cameroon was prepared by a staff team of the International Monetary Fund 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 March 14, 2008. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Cameroon or the Executive Board of the IMF.

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CAMEROON

Financial System Stability Assessment—Update

Prepared by the Monetary and Capital Markets and African Departments

Approved by Jaime Caruana and Benedicte Christensen

March 14, 2008

The Financial System Stability Assessment (FSSA) is based on the work of a joint IMF-World Bank mission that visited Cameroon as part of the Financial Sector Assessment Program (FSAP) in June 2007, building upon the Central African Economic and Monetary Community (CEMAC) regional FSAP that was conducted in 2006 and updating findings and recommendations of the 2000 Cameroon FSAP. The mission's objectives were to help the national authorities identify strengths and weaknesses of the financial system with a view to implementing an action plan focused on issues related to financial stability and credit access. The FSAP team was composed of Rodolfo Maino (Co-Leader, IMF) and Andres Jaime (Co-Leader, World Bank), Djibrilla Issa, Astrid Manroth, Pauline Aranda, and Ann Rennie (all World Bank); Romain Veyrune and Raju Singh (all IMF), and Piero Ugolini (IMF consultant). Ms. Kabedi-Mbuyi, Resident Representative in Cameroon, participated in some of the discussions and actively cooperated with the mission's work. As part of this undertaking, an anti-money laundering/combating the financing of terrorism Report on the Observance of Standards and Codes will be completed during the next 12 months.

- The performance of the banking system has improved and the assessment does not reveal immediate systemic risk. Some weaknesses remain, however, stemming from the low profitability and capitalization, high nonperforming loans (NPLs)and vulnerability to potential credit shocks of some domestic banks. Firm action from the Cameroonian authorities is needed to complete the restructuring of the housing bank (*Crédit Foncier de Cameroun, CFC*) and improve the performance of the financial services of the Cameroon Postal Services (CAMPOST).

- The assessment identified a number of impediments to the ability of the financial sector to contribute to growth, including: limits on banks' interest rates; lack of reliable financial information on borrowers; and weaknesses in the legal and judicial systems. Consequently, credit access for small- and medium-sized enterprises (SMEs) is adversely affected. The microfinance sector is growing although its supervision needs to be enhanced.

- Consistent with the findings and conclusions of the 2006 Regional FSAP for the CEMAC, the mission: (i) stressed the need to speed up the restructuring of specialized financial institutions; (ii) recommended action to deal with the underlying institutional impediments to credit access rather than create government-sponsored specialized financial institutions; (iii) urged the Cameroonian authorities to discontinue reliance on statutory advances from the regional Bank of Central African States (BEAC) and start issuing government securities instead.

The main authors of this report are Rodolfo Maino and Romain Veyrune (both from the Monetary and Capital Markets Department).

FSAPs are designed to assess the stability of the financial system as a whole and not that of individual institutions. They have been developed to help countries identify and remedy weaknesses in their financial sector structure, thereby enhancing their resilience to macroeconomic shocks and cross-border contagion. FSAPs do not cover risks that are specific to individual institutions such as asset quality, operational or legal risks, or fraud.

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GLOSSARY

BEAC	Bank of Central African States
CAMPOST	Cameroon Postal Services
CAR	Capital adequacy ratio
CEMAC	Central African Economic and Monetary Community
CFAC	Francs of the African Financial Community
CFC	*Crédit Foncier de Cameroun*
COBAC	Central African Banking Commission
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
HIPC	Heavily Indebted Poor Countries
IFRS	International Financial Reporting Standards
MFIs	Microfinance institutions
NPLs	Nonperforming loans
NPV	Net present value
OHADA	Organization for the Harmonization of African Business Law
SMEs	Small- and medium-sized enterprises

I. Overall Assessment of Stability, Integration and Development Issues

1. **The FSSA is based on the work of a joint IMF-World Bank mission that visited Cameroon as part of the FSAP in June 2007.** The evaluation built upon the CEMAC regional FSAP that was conducted in 2006 and updating findings and recommendations of the 2000 Cameroon FSAP. The mission's objectives were to help the national authorities identify strengths and weaknesses of the financial system with a view to implementing an action plan focused on issues related to financial stability and credit access.

2. **Consistent with the findings of the 2006 CEMAC regional FSAP, the short-term risks to the stability of the banking sector appear low although exposure to credit risk is high in domestic banks**. The banking system, which dominates the financial sector, has recently exhibited higher revenues and improved provisioning but NPLs are high. The observance of regional prudential regulations has improved significantly, but several banks still do not comply with the capital adequacy and risk exposure ratios. Compliance with prudential regulations differs based on bank's ownership: foreign-owned banks are better capitalized than domestic banks, which are also more vulnerable to credit risk. Profitability and solvency of the latter are under pressure due to decreasing interest margins.

3. **The financial problems of the two existing government-sponsored financial institutions argue against the creation now of new government-sponsored institutions to finance SMEs and agriculture.** The viability of the CAMPOST is uncertain and the freeze on deposits eroded its ability to attract new funds. While a management team was hired to improve the situation, this is unlikely to be achievable unless the institution is recapitalized and its information systems modernized. The CFC is also insolvent and it appears that its contribution to the development of housing finance in Cameroon has been limited. The CFC should be liquidated and subsidies for the housing sector should be better targeted. Against this background, the authorities should focus on addressing the obstacles to access to financial services (see below) rather than on establishing new government-sponsored financial institutions.

4. **Access to financial services, especially for SMEs, is limited due to a range of factors.** Overall, financial intermediation is among the lowest in Sub-Saharan Africa, with less than 5 percent of the population having access to banking services. The microfinance sector is becoming increasingly important and its supervision needs to be strengthened. The scope for developing financial products better suited to SMEs is constrained by weaknesses in the business environment and the binding limits on banks' lending rates. Against this background, high priority should be given to addressing legal and judicial weaknesses in order to strengthen the business environment.

5. **Box 1 presents recommendations that could have the most marked impact on the stability and development of the financial sector**.

Box 1. Main Findings and Recommendations

Key findings

- Prudential requirements at the regional level may not adequately reflect risks.
- The cap on lending rates is hampering credit access for SMEs and less creditworthy borrowers.
- The national treasury and central bank need to reorient their liquidity management toward market-based techniques.
- Reliable information on borrowers is limited.
- Lack of training of judges and governance problems in the judicial system hamper loan recovery and execution (foreclosing) of guarantees.

Key recommendations [1]

- Enhance the supervision of microfinance institutions (MFIs).
- Introduce treasury bills and develop the bond market.
- Address problem banks, especially those under administrative order and government-sponsored financial institutions.
- Raise minimum capital for domestic banks to increase resiliency to shocks.
- Enhance the information base on debtor risk, which entails building the capacity of SMEs to produce and disseminate financial information.
- Cease utilizing statutory advances and start issuing government securities instead.
- Improve commercial and land registries (by constantly updating the former and expanding the cover of the latter).
- Strengthen the judicial system (specialize some judges in commercial and financial law, and add commercial chambers within the largest court jurisdictions).
- Move towards a comprehensive adoption of the International Financial Reporting Standards (IFRS).

[1] The timeframe for implementing these recommendations will be set in the context of a financial sector strategy initiative currently being developed by the government.

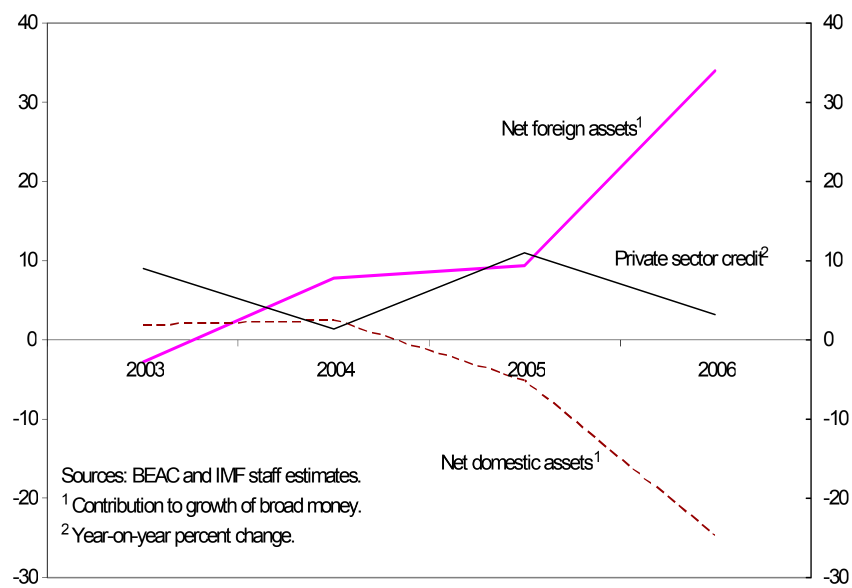
II. Macroeconomic Risks Affecting the Financial Sector

6. **Despite Cameroon's relatively diversified economy, the country is still exposed to commodity-related shocks.** Nonetheless, although the country faces a long-term decline in its oil production, favorable oil prices have ensured that oil continues to play a key role in the country's economy.[1] Dependency on commodity prices has also rendered macroeconomic performance volatile and uneven. Volatility in economic growth and a narrow economic base are also key sources of vulnerability for the banking sector.

7. **The government's creditworthiness has recently improved.** The external debt followed a rising trend during the 1980s and 1990s, reaching 90 percent of GDP in 1995–99, but has since been on a declining path (see Appendix Table 1). Recent efforts to strengthen macroeconomic performance have allowed Cameroon to reach the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative and qualify for additional debt relief under the Multilateral Debt Relief Initiative. As a result, the stock of external debt fell to 6 percent of GDP in 2006 and domestic arrears have been partially cleared via the issuance of government securities. The reduction of government liabilities to the banking sector helped contain broad money growth. Despite the increase in domestic liquidity, private sector credit growth slowed in 2006 as a consequence of a lack of viable projects and the improved cash-flow position of firms and banks following clearance of public sector arrears (Figure 1).

Figure 1. Recent Monetary Trends, 2003−2006

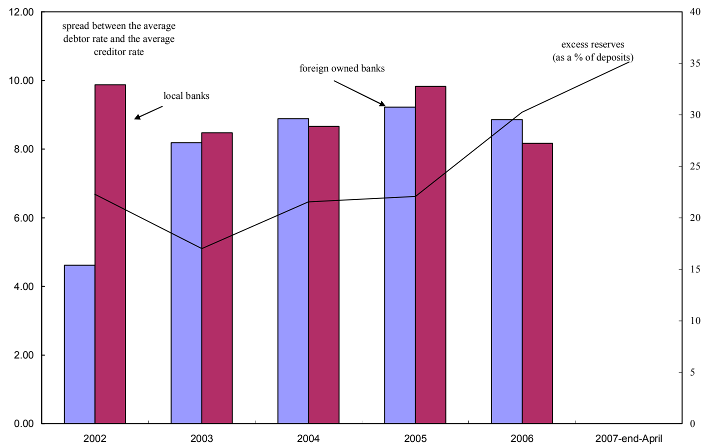
(Units indicated)



[1] Oil still contributes more than a third of government revenue and constitutes a half of the country's exports, despite accounting for about 10 percent of GDP.

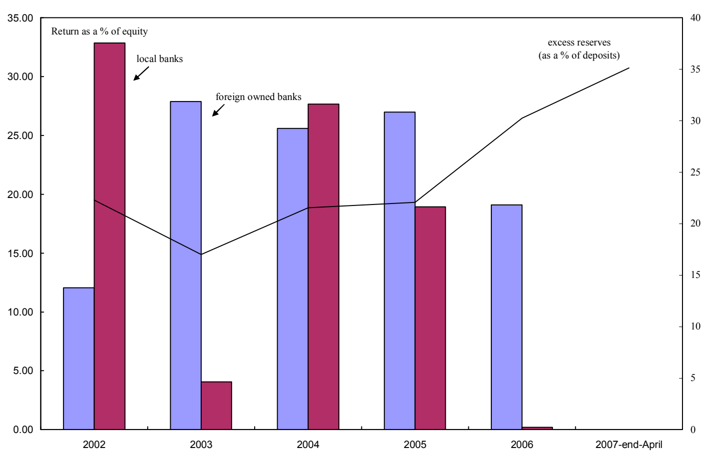
8. **The recent build up of excess liquidity in Cameroon could have adverse effects on the banking sector**.[2] Despite recent BEAC action,[3] excess liquidity has risen over the past years, mainly, as the result of: (i) oil revenue, which has facilitated government repayments of arrears; (ii) public administration deposits with banks (about 11 percent of total deposits); (iii) BEAC's statutory advances to the government; (iv) disparity between a growth in domestic deposits of 6.4 percent and a decline of about 6 percent in credit to the economy; and (v) BEAC's inability to implement appropriate sterilization policies.

Figure 2. Impact of Excess Liquidity on Banks' Margins



9. **Excess liquidity may be inducing banks to narrow their margins.** This has reflected an effort to attract customers from the limited pool of bankable borrowers (Figures 2 and 3). The lower spread and reduced profitability tilt domestic banks towards disintermediation and discouraged them from opening new branches. At the same time, there is concern that banks are lowering their credit standards and are providing credit to more risky activities. Considering the high level of nonperforming loans, this practice may have a negative impact in the future on banks' financial soundness and stability.

Figure 3. Impact of Excess Liquidity on Banks' Profits



[2] Excess liquidity, as defined as commercial banks' deposits at BEAC in excess of the minimum required, reached about 25 percent of total banks' deposits as of April 2007.

[3] In March 2007 reserve requirements for Cameroon were raised from 7.75 percent to 10.25 percent for short term deposits and from 5.75 percent to 8.25 percent for savings deposits. In May 2007 the BEAC established a deposit standing facility whereby banks can deposit excess liquidity.

Box 2. Main Conclusions of the CEMAC Regional FSAP

The findings of the CEMAC regional FSAP (IMF Country Report 06/321) were discussed by the Executive Board in the context of the discussion for the Article IV consultation with the CEMAC. The main conclusions were as follows:

- Regional integration of the CEMAC banking sector, which dominates the financial sector, is held back due to limited intra-regional trade and deficiencies in market infrastructure.

- The banking sector is vulnerable to a concentration of lending to a few sectors and clients, but the banks' capital shortfalls under the worst-case scenario would be limited due to the small size of the sector.

- The efficiency of the supervisory framework suffers from the limited institutional independence of the Central African Banking Commission (COBAC); insufficient consistency of the prudential norms being aligned with best practices; and inadequate resources allocated to the COBAC.

- Financial intermediation is among the lowest in Africa. Competition is held back due to limits on deposit and lending rates that are out of line with market fundamentals; severe deficiencies in the legal and judicial framework; the poor quality of financial data; and weak payment systems.

- The insufficient centralization of government deposits at the BEAC, together with weaknesses in the monetary policy frameworks, limits the ability of the BEAC to tackle effectively the current excess liquidity, and exacerbates financial sector vulnerabilities.

III. Financial Sector Structure and Vulnerabilities

A. Financial Sector Structure and Performance

10. **The financial sector is dominated by (largely foreign-owned) commercial banks**. Cameroon's financial system is the largest in the CEMAC, accounting for about half of regional financial assets. The banking system consists of eleven commercial banks (of which the six largest are foreign owned, with three holding more than 50 percent of the sector's assets and accounting for more than 55 percent of deposits) and two government-owned specialized financial institutions (CAMPOST and CFC). Nonbank financial institutions, insurance companies (including a government-owned reinsurance company), two pension funds, a social security fund and over 700 MFIs represent the remainder of the sector. Banks

deal mainly with large companies and other reliable counterparts. High credit risk, together with the lack of long-term deposits, has resulted in limited lending activities to SMEs and in the predominance of short-term lending. Except for one large bank, lending to agriculture and housing is limited.

11. **While the quality of banks' portfolio has improved, NPLs remain high and the profitability of the smaller domestic banks has dropped sharply**. NPLs declined from an average of 40 percent of total credit in 1995 to around 12 percent at the end of 2006 following the restructuring of the banking sector and the transfer of impaired loans to a loan recovery agency in the late 1990s. The substantial reduction in government domestic arrears in recent years has also contributed to the improvement in asset quality. Banks remain profitable but excess liquidity has led to a reduction of interest margins and profits, especially for the domestic banks, which are left with less creditworthy borrowers, in particular SMEs, due to increasing competition from the large banks. As a result, NPLs for small banks have reached more than 15 percent of gross loans (11 percent for the other banks) and their return on equity plummeted to 1.7 percent compared to more than 20 percent for the other banks.

12. **The COBAC reports that the observance of regional prudential regulations has improved significantly, but several banks still do not comply with the capital adequacy and risk exposure ratios**. The latter reflects the narrow lending base and the banks' increasing tendency to concentrate lending to a few large creditworthy customers. Two domestic banks were placed under administrative order and another domestic bank is being closely monitored by the COBAC. Furthermore, the COBAC has taken steps to strengthen enforcement of the concentration ratio, including suspending the distribution of profits to shareholders until compliance is restored. MFIs account for a significant and increasing share of deposits and credits but corporate governance remain weak and the sector's regulatory framework, which came into effect in 2005, is yet to be implemented. The partial supervision of this sector, given the limited resources by the COBAC, is a matter of concern.

13. **Compliance with the prudential regulations differs based on the bank's ownership.** While foreign-owned banks appear well-capitalized and their solvency ratios are above the required 8 percent, four out of the 11 banks do not comply with solvency requirements owing to large NPLs involving SMEs and delays in their recapitalization. The two banks recently intervened by the COBAC represent about 5 percent of the sector and their management has been replaced. Another domestic bank, which represents 10 percent of the assets of the banking sector assets, is also in a very weak position. As a result of the low level of capitalization of the domestic banks, the sector's overall capitalization is lower than in the other CEMAC countries.

14. **The Ministry of Finance has indicated that it abides by the COBAC rules on financial supervision matters although it may have strong views on banks' liquidation**. The Ministry issues bank licenses after consultation with the COBAC. Likewise, it

withdraws licenses when banks go out of business or as a disciplinary action. For this last purpose, the COBAC could also withdraw licenses. Generally, the Ministry follows the COBAC recommendations regarding licensing. It also complies with the disciplinary procedure initiated by the COBAC but tends to avoid license withdrawal (liquidation) because of its social costs. The timely withdrawal of licenses would reinforce the credibility of banking supervision.

B. Stress Tests, Soundness, and Short-Term Vulnerabilities

15. **Foreign-owned banks appear resilient to most of the shocks, but domestic banks are highly exposed to credit risk.**[4] Due to relatively high levels of capitalization, foreign-owned banks withstood (i.e., their capital adequacy ratio remains above 8 percent) all the simulated shocks except for credit risk. Like other banks in Cameroon, foreign-owned banks are exposed to loan concentration risk. Default by the three largest borrowers would absorb almost all of the regulatory capital, and capital shortfalls would amount to five times the required minimum capital. Given that foreign-owned banks often share the same large borrowers, a default by the largest borrowers could have systemic implications.

16. **Stress tests confirmed that the domestic banks were most vulnerable to shocks given their low level of capital, high loan concentration, and large stock of NPLs.** These results suggest that the minimum capital for domestic banks should be raised to increase resiliency to shocks, and the risk concentration limits should be fully enforced.

C. Specialized Financial Institutions[5]

17. **The authorities are in the process of restructuring two insolvent government-sponsored specialized financial institutions (Box 3).** Mainly due to poor management and corporate governance issues, the CFC and the financial services of the CAMPOST have faced difficulties for several years. At the end of 2005, the authorities replaced senior management and the Board of Directors of the CFC and a restructuring process was put into motion. So far, the new management has improved collection, but has not yet succeeded in expanding its loan portfolio, reducing costs, or establishing reliable control and accounting systems. In February 2007, the authorities entered into a management contract for the restructuring of the CAMPOST with a Canadian company.

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[4] The tests focused on credit, exchange rate, and liquidity risks and the results are reported in Appendix Table 4.

[5] In addition to Campost and CFC, there are two other state-owned specialized financial institutions, the *Société Nationale d'Investissement* and *Société de Recouvrement de Cameroun*.

Box 3. Cameroon: Specialized Financial Institutions

The financial activities of the Cameroon Postal Services have been technically insolvent for many years due to a cumbersome operational and personnel structure and lack of basic management tools and information systems. Until recently no reliable financial statements existed: the 2004–06 financial accounts have just been produced.

Crédit Foncier du Cameroon, a leading real estate lender in the CEMAC with assets hovering around francs of the African Financial Community (CFAF) 100 billion had been insolvent for many years**.** The CFC has been financed primarily by a 3.5 percent withholding tax on wages split between employers and employees directly allocated to CFC and it has also been recapitalized by the government in 2006. Soaring operating costs and lax credit policies have resulted in operating losses and a ratio of NPLs to gross loan over 80 percent. Currently, proceeds from the withholding tax are used mainly to cover operating losses. An attempt to diversify into commercial banking activities resulted in even higher losses.

18. **While the performance of the CFC has fallen short of expectations, this can be partly attributed to factors beyond its control.** In particular, the institution does not appear to have made a major contribution to housing finance (mortgages by CFC and other financial institutions represent less than 0.6 percent of GDP in Cameroon). The lack of housing finance is partially attributable to factors outside of the financial system. In particular, housing prices in the formal sector are beyond the reach of most households, and there are also bottlenecks in the production of new housing related to land ownership and construction problems. Obstacles in the legal and institutional environment are also a deterrent to housing finance. Land registries cover less than 1 percent of the country's territory and their integrity cannot be assured. Also, the restricted scope of credit registries and other databases relating to individuals makes it difficult to assess the solvency of potential borrowers. Finally, the lack of long-term resources constitutes a major obstacle to the development of a mortgage market.

IV. Financial System Development

A. Constraints to Access to Financial Services

19. **Access to financial services is limited in Cameroon.** Less than 5 percent of Cameroon's total population held a bank account or used bank credit services at the end of

2006, a lower ratio than in countries with a similar level of development.[6] Furthermore, banks provide a narrow range of financial products: loans are for the most part short term, although with a growing volume of medium-term loans, and savings products are the most basis ones (demand and term deposits and passbook savings accounts).

20. **Cameroon's banking sector, especially the largest banks, provides limited financing to SMEs**.[7] Three of the eleven commercial banks and three of the nonbanking financial institutions are specifically targeting SMEs as their main customers, and two other banks have special units dedicated to financing for SMEs. However, the number of loan accounts for SMEs in these financial institutions is estimated at only 11 percent, and outstanding loans to SMEs accounted for only 14 percent of the banking system's total outstanding loans at the end of 2006. Some banks are concluding strategic alliances with MFIs in order to explore and deepen their penetration of the SME market. These alliances should be encouraged and supported by the authorities, but their development and sustainability require a strengthening of the supervisory capacity of MFIs for which the capacity of COBAC seems to be a constraint.

21. **Amendments to the legal and regulatory frameworks would help diversify the range of financial products targeted at SMEs and family firms**. Weaknesses in the legal and regulatory frameworks are impediments to the development of leasing or factoring, and to the emergence of venture capital and private equity institutions. Amendments to the legal and regulatory framework should aim at adopting regulatory and prudential frameworks for leasing that specifies, inter alia, the rights and obligations of the parties to any leasing contract. It would also be desirable to establish a specific legal, regulatory, and prudential framework for factoring, private equity, and venture capital firms.

22. **Rigidity of regulations governing the opening and closing of bank branches may contribute in making physical access to bank services difficult.** Banks' outreach declined since the restructuring of the sector in the 1990s and branches are now concentrated in the major cities. Opening a branch requires authorization from the Ministry of Finance, acting in consultation with the National Credit Council of the respective country. Also, the requirements for closing a branch do not seem to be clearly spelled out in the regulations, meaning that banks may perceive a degree of subjectivity in decisions authorizing branch closures.

23. **The lack of financial and accounting information constrains further the financing of SMEs.** According to banks, small borrowers (as well as some larger ones) do

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[6] On the basis of a survey by the World Bank on banking access indicators, Cameroon falls short of the average (51.34 banks accounts per 1,000 inhabitants) regarding availability of loan accounts (14.39 in Cameroon).

[7] The lack of special units for lending to SMEs in the other commercial banks means that data on lending to this sector are not always available or accurate.

not keep accurate accounts and do not provide all the information that banks need to make decisions on loans. The lack of information, therefore, restricts banks' knowledge of this market segment and restricts the possibilities for providing services to SMEs. Cameroon has enacted a chart of accounts that considers the constraints faced by small companies. In addition, the capacity of SMEs to provide such information is weak and needs to be reinforced.

24. **Financial institutions do not have access to a reliable database on potential customers.** BEAC set up a Credit Registry in the 1970s and has plans to create a Central Balance Sheet Database and a Central Payment Incident Database. However, the efficiency of the Credit Registry needs to be enhanced, and it will be important to ensure that synergies are created between the various databases so as to ensure their effective integration.

25. **Consistent with the findings in the CEMAC regional FSAP, the ceiling on lending rates is an obstacle to the provision of credit to the small and riskier customers.** Banks consider that the current 15 percent ceiling insufficient to cover the perceived risk of lending to SMEs, although fees that are added to the base interest rate may lead to much higher lending rates. Therefore, it would be appropriate to consider (i) abolishing the ceiling; (ii) conducting an in-depth analysis of banks' rates and fees with a view to developing a formula which would identify the direct costs, along with the implied and indirect costs of banking services; (iii) requiring banks to notify each borrower of the true cost of their loan using a uniform indicator before signing the loan contract; (iv) requiring banks to report their prime lending rates and their minimum and maximum lending and deposit rates to COBAC on a regular basis, along with any increases or decreases in these rates; and (v) posting the rates reported by the banks on the COBAC Web site.

26. **The improvement in the financing of SMEs is a necessary but not sufficient condition for the development of the SME sector.** While there is considerable scope for progress with regard to the supply of finance to SMEs, there are obstacles from the demand side as well. In particular, access issues need to be considered within the broader context of improving the business environment. These actions should include support for SMEs to strengthen their technical, administrative, and financial management capacities.

27. **High taxation of financial products increases the cost of financing.** The value added tax on leasing contracts and SMEs' problems managing value-added tax seem to be an obstacle to the development of financial services in Cameroon. The authorities should develop a clear policy on taxation of financial products that would promote the development of the financial sector by reducing distortions.

B. Proposed new Development Finance Institutions

28. **The government is planning to establish two new public development finance institutions with a view to promoting SMEs and agricultural finance.** Plans for the establishment of a specialized institution for SME financing appear to be well advanced. The

mission questioned the appropriateness of this step, especially since that previous government efforts to promote agriculture and SMEs through government-sponsored specialized financial institutions have failed.[8]

29. **The most effective way for the government to increase access to credit for underserved markets would be to tackle the underlying obstacles to financial intermediation.** There is widespread consensus on the importance of strong institutions and an appropriate enabling environment in order to develop the financial sector. This includes notably clear "rules of the game;" efficient, speedy, and fair courts; effective liens and contract enforcement; and accurate credit and financial information. The absence of these fundamental prerequisites to financial sector development in Cameroon results in gaps in the provision of credit, particularly to market segments that may be perceived as risky, such as agriculture or SMEs. The creation of specialized state-sponsored institutions will not resolve the underlying causes of these gaps and may distract from the difficult task of dealing with the underlying problems. If the government decides that it is necessary to intervene to promote market access, this should be complemented with institutional reforms, and the interventions should be well-designed, limited in time and scope.

C. Government Securities Market

30. **Cameroon is planning to issue government securities in the domestic market as a substitute to the statutory advances from the BEAC**. The project, which is expected to be completed by the first quarter of 2008, envisages the issuance of government securities in book-entry form to facilitate secondary market activities, and will supplement the current market of securities issued in the past to repay arrears.

31. **There appears to be room for strengthening cooperation between the BEAC and the government.** In particular, it is necessary to establish the appropriate market infrastructure (i.e., regional auction mechanism and primary dealer-type system) to ensure the smooth functioning of the primary market as well as to support the secondary market. There is also the need to strengthen cash-flow projections at the Treasury so that a reliable calendar of issuance can be produced, and coordination with liquidity management by the BEAC is effective. Finally, there is a need to develop an effective medium-term debt management strategy to guide the issuance of bonds that could be used to finance the budget.

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[8] In the past, two government-sponsored agricultural development banks had to be liquidated.

V. Strengthening the Business Environment

A. Legal and Judicial Environment

32. **While the applicability of the OHADA[9] framework in the common law Anglophone provinces of Cameroon has been resolved, difficulties in its implementation remain.** Cameroon is a bilingual country with two parallel legal traditions (civil law and common law), while the OHADA framework is mainly based on the principles of civil law. The harmonization of Cameroonian domestic law with OHADA has not been fully completed. Civil proceedings and commercial registries have not been updated. Bankruptcy receivers, whose responsibilities have been considerably expanded in the OHADA text on collective proceedings, are not always regulated or effectively supervised. In addition, problems related to loan recovery and execution (foreclosing) of guarantees is weighing on the financial sector where the actual "realization" rate of mortgages is low thereby weakening the position of the overall banking sector.

33. **The poor technical quality of translations makes it very difficult to reconcile a number of OHADA concepts that are based on civil law with their equivalent concepts in common law.** Some harmonization work has been done in Cameroon but civil proceedings and commercial registries have not been updated. The following issues are still pending

- ***Regarding secured transactions***, there are problems of legal enforcement of guarantees, weaknesses of the judicial system and poor oversight over the creation and formalization of guarantees by the legal units of financial institutions.

- ***The land tenure system*** in place in Cameroon is not conducive to the constitution of real property collateral or access to loans based on mortgages. Furthermore, land-related procedures are known to be extremely lengthy, tedious, and costly. In addition, the procedures for formal land ownership are complex and restrictive.

- ***Debt collection and the enforcement of mortgages and other collateral remain problematic.*** The OHADA Uniform Act on simplified recovery procedures and measures of execution is considered to be complex and excessively formal, which encourages the use of dilatory tactics by debtors and contributes to lengthening judicial proceedings.

- ***Commercial and financial disputes are heard by magistrates with no specialization in financial matters.*** Magistrates are generally unfamiliar with business and financial law and the lack of true specialization of magistrates is viewed as a major obstacle to

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[9] Organization for the Harmonization of Business Law in Africa (*Organisation pour l'Harmonisation en Afrique du Droit des Affaires*).

the effectiveness of the judicial system, as it leads to ambiguities and inconsistencies in rulings.

B. Accounting and Auditing

34. **The legal framework for accounting and auditing framework is made up of the superposition of regional (OHADA Uniform Acts), CEMAC Regulations and Decisions, and national laws and regulations.** This architecture, while contributing to Cameroon's integration with neighboring countries, makes the legal system cumbersome and requires major coordination efforts to adjust.

35. **There is room for updating the OHADA chart of accounts according to international standards.** The level of information provided by the OHADA chart of accounts is considerably lower than that now expected by international investors and lenders and a move to adopt IFRS would be desirable. The OHADA chart of accounts also imposes excessive constraints on SMEs, while IFRS comes with a set of reporting standards for SMEs. Furthermore, concerning implementation at the national level, the lack of comprehensive professional standards for auditors and the lack of quality control for accounting and auditing practices give rise to serious concerns about the reliability of auditing. With regard to banks, current regulations do not require to make their audited financial statements public, though some of them do. COBAC chart of accounts, which has not been updated in more than a decade and differs from IFRS in many areas, including recognition, valuation, presentation, and disclosures.

APPENDIX I. STRESS TEST RESULTS

36. The main vulnerabilities of the banking sector arise from its loan concentration (credit risk) and from the possible failure of some domestic banks (crisis scenario).[10] The tests focused on credit, exchange, and liquidity risks. The results are presented as changes in the capital adequacy ratio (CAR) separately for the six foreign banks and the five domestic banks.

37. To assess the risk stemming from loan concentration, two scenarios were examined where (i) the largest borrower defaults; and (ii) the three largest borrowers default. After the first shock, the CAR drops by 4 percent, resulting in a need for capital corresponding to half of the minimum capital in order to reach the 8 percent CAR. The default of the three largest borrowers would absorb the capital of the whole system. An injection of capital equal to eight times the minimum capital would be necessary to bring the CAR to 8 percent. The effort would be less for foreign banks because of their high level of regulatory capital. More specifically:

- the default of the two borrowers that have large loans with several banks lead to a drop of the CAR by 3 percentage points. Foreign banks, which share all these large clients, do not have to increase their capital because of their high initial CAR;
- the default of the oil company, which has loans in several banks, would result in a slight deterioration of the CAR (2.1 percentage points). Only the domestic banks would need to increase their capital to maintain their initial solvency ratio; and
- the default of banks' foreign correspondent (banks keeping important deposits in their correspondent account) would lead to a fall of 1 percent in the CAR of the system. The need to increase capital would be low.

38. Banks have long foreign exchange positions. They are, thus, vulnerable to an appreciation of the CFAF vis-à-vis the Euro, which is unlikely given the peg. Only some domestic banks would be vulnerable to a large depreciation of CFAF with respect to the dollar.

39. Banks have high liquidity ratios. Thus, a massive run on deposits (25 percent of the deposits) or the withdrawal of government deposits would make no bank of the system illiquid. It should be noted that the public sector continues to have a significant influence on the liquidity of the system. Although the two domestic intervened banks under intensive supervision are liquid, redeeming deposits not covered by their capital and liquid assets would require a one-time injection of the minimum capital of the system. If the crisis spreads and the other fragile bank needs to be liquidated, the cost increases; it reaches 100 percent of the regulatory capital of sound (foreign-owned) banks. In this case, the monetary authorities would need to intervene to bail out the system.

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[10] It is assumed that (i) when banks' creditors default, the asset is fully unrecuperated given the poor judiciary enforcement of claims; and (ii) when a bank defaults, it pays back deposits net of capital.

Table 1. Cameroon: Selected Economic and Financial Indicators, 2004–09

	2004	2005	2006	2007 Prog.	2007 Proj.	2008 Prog.	2008 Proj.	Proj. 2009
	(Annual percentage changes unless otherwise indicated)							
National income and prices								
GDP at constant prices	3.7	2.3	3.2	4.2	2.7	4.9	4.4	4.6
Oil	-9.3	-9.5	7.7	0.6	-7.5	0.7	2.4	-1.0
Non-oil	4.9	3.2	2.9	4.4	3.4	5.2	4.5	4.9
GDP deflator	1.5	2.6	3.9	1.2	1.8	1.9	2.0	0.6
Consumer prices (12-month average)	0.3	2.0	5.1	1.8	1.5	1.8	3.3	2.0
Nominal GDP (billions of CFAF)	8,334	8,750	9,388	10,095	9,812	10,794	10,443	10,990
Oil	541	734	955	727	841	799	870	771
Non-oil	7,792	8,016	8,433	9,368	8,971	9,995	9,573	10,219
Oil output (thousands of barrels a day)	89	82	87	88	84	86	85	83
External trade								
Export volume	-0.7	-8.2	8.1	4.2	2.8	3.6	4.0	4.0
Of which: Non-oil sector	2.9	-8.3	8.7	5.0	5.1	5.4	5.4	5.9
Import volume	11.2	3.6	7.1	5.4	9.6	5.5	3.7	3.3
Average oil export price (U.S. dollars per barrel)	34.9	50.4	61.6	50.0	62.8	54.8	65.0	59.3
Nominal effective exchange rate	1.8	-4.4	3.2	...	...	...	...	...
Real effective exchange rate	0.1	-3.5	4.5	...	...	...	...	...
Terms of trade	-2.2	16.8	11.8	-14.6	-6.1	0.4	-3.1	-6.3
Non-oil export price index (CFAF)	-8.3	3.2	10.2	-2.0	-1.5	-1.9	-2.5	-2.6
Money and credit (end of period)								
Net domestic assets 1/	0.3	-5.3	-24.8	-0.4	-8.1	-5.0	-4.7	-4.0
Net credit to the public sector 1/	0.1	-8.7	-21.7	-3.8	-9.6	-9.2	-8.0	-7.1
Credit to the private sector	1.4	10.9	3.2	6.8	3.0	8.5	6.5	6.2
Broad money (M2)	7.3	4.2	9.3	6.7	3.7	7.7	7.2	5.2
Velocity (GDP/average M2)	5.8	5.9	5.8	5.7	5.7	5.8	5.8	5.8
Central government operations								
Total revenue	-0.4	21.8	17.1	1.6	1.2	7.8	7.4	5.6
Of which: Non-oil revenue	-0.7	17.3	5.5	12.1	7.3	7.8	6.7	8.2
Total expenditure	9.2	-4.0	6.7	16.3	17.1	7.3	6.8	9.0
	(Percent of GDP; unless otherwise indicated)							
Gross national savings	15.1	15.6	16.7	17.2	17.0	17.7	17.2	17.3
Gross domestic investment	18.9	19.1	16.8	20.1	18.4	21.5	19.4	20.0
Central government operations								
Total revenue (excluding grants)	15.2	17.6	19.3	17.7	18.6	17.9	18.4	18.5
Oil revenue	3.9	5.0	6.8	5.2	5.9	5.2	5.4	5.1
Non-oil revenue	11.3	12.6	12.4	12.6	12.7	12.7	13.0	13.3
Non-oil revenue (percent of non-oil GDP)	12.1	13.8	13.8	13.6	13.9	13.7	14.2	14.4
Total expenditure	16.0	14.6	14.5	16.8	16.3	16.8	17.3	17.9
Noninterest expenditure 2/	13.1	12.6	12.6	14.6	14.6	14.7	15.2	16.0
Capital expenditure 3/	1.9	2.3	2.6	4.3	3.9	4.9	4.7	5.5
Fiscal balance (excluding net changes in arrears)								
Excluding grants	-0.8	3.0	4.7	1.0	2.4	1.0	1.1	0.5
Including grants	-0.5	3.6	33.1	2.3	3.9	2.1	1.9	1.5
Primary balance 4/	1.9	5.0	6.3	2.5	3.7	3.0	2.8	2.3
Non-oil primary balance (percent of non-oil GDP) 4/	-2.1	0.0	-0.6	-2.8	-2.4	-2.4	-2.9	-3.0
External sector								
Current account balance (including grants)	-3.8	-3.4	-0.1	-2.8	-1.4	-3.9	-2.2	-2.7
Gross official reserves	9.3	10.8	14.3	8.7	16.9	13.1	20.3	22.0
Stock of external debt 5/	44.2	36.7	6.1	5.6	6.2	6.7	7.2	8.2
Stock of public debt	61.3	51.5	15.7	12.4	13.3	11.7	12.5	13.2
	(Percent of exports of goods and services; unless otherwise indicated)							
Net present value (NPV) of external debt after HIPC, bilateral relief beyond ... 6/	26.3	11.0	15.8	12.3	16.9	15.8	20.0	24.1
External debt service 7/	7.1	6.7	2.6	1.7	1.4	1.7	1.5	1.6
External debt service (as a percent of government revenue)	10.8	9.2	4.5	2.7	2.4	2.8	2.6	2.6

Sources: Cameroonian authorities; and IMF staff estimates and projections.

1/ Percent of broad money at the beginning of the period.
2/ Excluding foreign-financed investment, restructuring expenditure, and separation grants.
3/ Excluding restructuring expenditure.
4/ Excluding grants, interest, and foreign-financed capital expenditures.
5/ Assumes cancellation of C2D debt in 2006.
6/ NPVs calculated using the LIC DSA methodology.
7/ Actual payments through 2006, and after all expected debt relief thereafter.

Table 2. Cameroon: Financial Soundness Indicators 1/

(In percent)

	Cameroon					CEMAC				
	2002	2003	2004	2005	2006	2002	2003	2004	2005	2006
Capital adequacy ratio										
Regulatory capital/risk weighted assets	9.3	9.8	8.0	11.2	12.0	11.4	12.8	11.1	15.1	...
Net capital/total assets	6.9	8.4	8.4	8.7	8.5	10.5	11.7	11.4	10.8	...
Asset quality										
Gross NPL/gross loans	15.2	13.7	13.5	12.1	12.4	13.7	14.1	14.8	13.4	...
Net loans/capital	-5.6	-4.5	-4.1	7.1	10.8	3.0	8.3	7.1	6.9	...
Profitability										
Asset return	1.1	2.0	2.3	2.2	1.2	1.5	1.9	2.5	1.0	...
Equity return	16.0	24.0	27.1	24.9	14.5	14.5	15.9	22.2	9.2	
Net interest income/total income	34.0	27.7	30.5	35.4		34.3	30.7	30.5	35.4	
None interest expenditure/total income	66.4	45.4	54.4	64.8		68.8	69.8	63.8	64.8	
Wage and salaries/total income	53.6	67.6	63.8	56.1		51.4	49.0	54.4	56.1	
Loans/deposit spread	4.2	6.1	6.5	7.2	5.6	5.9	7.0	7.0	3.8	
Liquidity										
Liquid assets/total assets	55.7	52.3	54.1	53.3	56.4	54.4	52.5	54.1	57.2	
Liquid assets/short term liabilities	76.8	76.6	81.3	67.3	89.3	82.7	80.0	81.3	82.7	
Reserve/demand deposit	27.2	22.1	26.3	27.2	34.6	21.6	23.0	26.5	31.4	
Households deposit/noninterbank loans	71.7	78.4	73.6	74.2	68.2	81.3	83.2	75.3	65.9	
Sensitivity to market risk										
Net open position/capital	98.4	142.9	175.7	182.4	91.8	64.9	266.5	294.2	115.0	

Source: The Central African Banking Commission staff calculations.

1/ It should be noted that different risk weights used prior to 2005 as indicated in IMF Country Report 06/321.

Table 3. Cameroon: Prudential Indicators of the Banking System 2000−05

(In percent)

	Foreign Banks					Domestic Banks				
	2002	2003	2004	2005	2006	2002	2003	2004	2005	2006
Capital adequacy ratio										
Regulatory capital/risk weighted assets	9.9	10.4	10.3	14.2	16.9	7.2	8.6	7.9	4.2	2.5
Net capital/total assets	7.0	4.6	9.0	8.9	9.2	6.4	7.1	8.3	8.1	7.0
Asset quality										
Gross NPL/gross loans	13.21	10.90	11.39	11.31	11.29	25.8	23.7	12.8	16.2	15.2
Net loans/capital	5.88	6.20	5.82	9.46	11.56	33.1	61.8	5.2	-15.4	21.6
Profitability										
Asset return	0.8	2.5	2.3	2.4	2.4	2.1	0.3	2.3	1.5	0.5
Equity return	12.1	27.9	25.6	27.0	26.7	32.9	4.1	27.7	19.0	0.2
Net interest income/total income	31.0	29.3	30.4	36.3	36.1	40.9	25.1	29.4	32.8	29.7
Noninterest expenditure/total income	68.1	63.6	63.6	56.1	44.9	62.3	79.3	63.4	62.5	47.1
Wage and salaries/total income	54.2	49.6	53.6	57.1	53.0	52.1	36.7	51.9	53.2	34.1
Loans/deposit spread	4.6	8.2	8.9	9.2	8.9	9.9	8.5	8.7	9.8	8.2
Liquidity										
Liquid assets/ total assets	55.4	52.1	53.9	53.4	54.8	56.9	50.8	53.8	53.1	60.2
Liquid assets/short-term liabilities	75.2	75.9	78.1	75.7	75.7	89.9	82.6	79.5	79.7	79.2
Reserve/demand deposit	27.3	21.3	26.5	26.2	33.8	26.6	26.4	26.1	30.0	36.4
Households deposit/noninterbank loans	70.6	78.4	72.9	75.6	68.9	76.2	84.6	74.7	70.4	66.3
Sensitivity to market risk										
Net open position/capital	92.9	150.1	118.2	118.5	227.9	122.1	304.2	190.2	265.9	179.6

Source: The Central African Banking Commission staff calculations.

Table 4. Cameroon: Stress Tests Results

	Solvency Ratio	Capital Needs		
		System	Foreign Banks 1/	Domestic Banks 2/
Solvency ratio (CAR)	11.8	...	16.9	1.5
	(After shocks)	(Capital needed/minimum capital)		
A. Credit risks				
Default of the largest borrowers	7.4	0.5	0.0	2.6
Default of the three largest borrowers	-1.1	8.0	5.4	6.7
Default of shared risks	8.0	0.0	0.0	0.0
Default on oil financing	9.7	0.0	0.0	1.5
Default on correspondent accounts	9.3	0.0	0.0	0.3
Degradation of nonperforming loans	10.9	0.0	0.0	1.1
Increase of nonperforming loans by 50 percent	6.7	1.1	0.0	3.5
B. Foreign exchange risk				
40 percent depreciation against the euro	18.51	0.0	0.0	0.0
40 percent appreciation against the euro	8.45	0.0	0.0	1.4
40 percent depreciation against the dollar	13.14	0.0	0.0	0.5
40 percent appreciation against the dollar	10.46	0.0	0.0	0.0
D. Liquidity risk				
Liquidity ratio 3/	58.4			
Liquidity ratio after the shock				
25 percent withdrawal of total deposits	33.4			
50 percent withdrawal of central government and public enterprise deposits	40.7			
E. Crisis scenarios		(As percent of foreign-owned bank capital)		
Closure of the two intervene banks	6.9	9.0		...
Closure of the three banks in difficulties	-3.3	100.0		...
Recapitalization of four bank with a CAR < 8 percent	14.6	19.0		...
Recapitalization of all bank to a CAR of 12 percent	15.4	32.0		

1/ Increase in capital to reach the level of 8 percent of CAR.
2/ Increase in capital to reach the initial level of CAR
3/ Assets and liabilities with a duration of one month or less; COBAC compute these ratios base on weights.