

**LAPSE OF
TIME**

SM/22/82

Correction 2

May 10, 2022

To: Members of the Executive Board

From: The Secretary

Subject: **West African Economic and Monetary Union—Financial System Stability
Assessment**

Board Action: The attached corrections to SM/22/82 (4/13/22) and Cor. 1 (4/27/22) have been provided by the staff:

Typographical Errors **Pages 5, 15, 16, 18, 20, 21**

Questions: Mr. Veyrune, MCM (ext. 34822)
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Glossary

AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
BCEAO	Central Bank of West African States (In French: <i>Banque Centrale des États de l'Afrique de l'Ouest</i>)
BIC	Credit Reporting Bureau (In French: <i>Bureaux d'information sur le crédit</i>)
BOAD	West African Development Bank (In French: <i>Banque Ouest-Africaine de Développement</i>)
CBU	Banking Commission of the West African Monetary Union (In French: <i>Commission Bancaire de l'UMOA</i>)
CM	Council of Ministers of the WAEMU
CREPMF	Regional Public Investment and Financial Markets Board (In French: <i>Conseil Régional de l'épargne publique et des marchés financiers</i>)
CSF-UMOA	Financial Stability Committee of the WAEMU (In French: <i>Comité de Stabilité Financière dans l'UMOA</i>)
ECOWAS	Economic Community of West African States
ELA	Emergency Liquidity Assistance
FGDR-UMOA	Deposit Guarantee and Resolution Fund (In French: <i>Fonds de Garantie des Dépôts et de Résolution</i>)
FSAP	Financial Sector Assessment Program
HQLA	High Quality Liquid Assets
IMF	International Monetary Fund
LCR	Liquidity Coverage Ratio
ML/TF	Money Laundering and Terrorism Financing
NPL	Nonperforming Loan
PEP	Politically Exposed Person
RAM	Risk Assessment Matrix
SGCB	General Secretariat of the CBU (In French: <i>Secrétariat General de la CBU</i>)
SME	Small and Medium-sized Enterprise
SVT	Primary Dealers in Treasury Securities (In French: <i>Spécialistes en Valeurs du Trésor</i>)
UT	Securities Agency of the WAEMU (In French: <i>UMOA-Titres</i>)
WAEMU	West African Economic and Monetary Union

requirement should be based on Basel Pillar 2 or, alternatively, on Pillar 1 with an accompanying macroprudential rule. The difference in the two approaches relates to the institution in charge (the CBU for Pillar 2 and the BCEAO for Pillar 1) and the extent of public disclosure (the Pillar 1 approach entails publication of regulations).

29. The supplementary capital requirement could be extended to cover other risk types, including:

- **Large exposures to private borrowers.** The additional requirement (Pillar 2) has the advantage of accounting for more specific concentration factors, such as the correlation of risks between borrowers and sectoral exposures. It is an important complement to the Basel large exposure limit—which the authorities are strongly encouraged to implement as planned by 2023—to offset concentration risks in the banking sector.
- **Interest rate risk.** The additional requirement (Pillar 2) should be commensurate with the maturities and interest rate mismatches in banks’ balance sheets, which necessitates measuring these on a regular basis.

30. The mission supports the authorities’ efforts to encourage banks to internalize liquidity risks. An LCR requirement is expected to be introduced soon and then gradually increased to 100 percent by 2028. It is important that the requirement abides by the following:

- The haircuts on high-quality liquid assets (HQLA) should reflect the assets’ market liquidity, as revealed by liquidity indicators, to achieve risk equivalence. If the regulator opts not to apply different haircuts across sovereign issuers, a uniform haircut should be introduced at a minimum.
- Required reserves could also be counted toward HQLA without applying a discount since they are available to absorb temporary liquidity needs.¹¹
- Over time, LCR requirements should be differentiated based on banks’ relative liquidity risk profiles under the Basel Pillar 2 approach.

31. The introduction of Basel liquidity ratios will require a systematic data collection process by the supervisor. To permit the introduction of higher Pillar 2 requirements on banks more prone to larger outflows, the regulator should develop capacity to monitor the distribution of monthly changes in banks’ various funding sources. Introducing the long-term liquidity ratio should entail regular reporting requirements on the residual maturities of banks’ assets and liabilities to enable ongoing monitoring of maturity mismatches.

¹¹ See [Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools](#).

FINANCIAL SECTOR SUPERVISORY FRAMEWORK

A. System-level Oversight

Institutional Architecture

32. WAEMU’s institutional framework for financial stability and the legal mechanisms underpinning its functioning have seen substantial progress since the 2008 FSAP. Institutional reforms have clarified the mandates of the BCEAO and the CBU and strengthened the CBU’s legal autonomy and enforcement powers. In addition to the objective of preserving price stability, the BCEAO has explicitly been charged with the core task of ensuring financial stability. The law on the banking regulatory framework has established an overarching framework for the supervision of banks’ activities, which has been made more proactive and risk based with the gradual implementation of the Basel II/III framework since 2016. A macroprudential policy framework, a bank resolution regime, and a deposit guarantee fund—whose mandate was extended to bank resolution funding—have been introduced.

33. The CBU’s independence from member states should be strengthened. The principle of independence, which prohibits CBU members from receiving instructions from external entities, including member states, should be explicitly enunciated in the CBU’s governing documents (specifically the Annex to the CBU’s governing Convention). The CBU’s governing documents should also stipulate that commissioners serving on the Supervisory Board because of their status or position in a WAEMU member state’s administration (eight of the 16 members) should do so in a non-voting capacity. As an alternative, the CBU’s composition could be amended to increase representation of CM-nominated commissioners based on professional qualifications. Finally, maintaining the CM’s appellate jurisdiction over CBU decisions raises institutional independence concerns. As per good practices, such decisions should only be appealed before the WAEMU’s Court of Justice, which also has jurisdiction on these matters.

Macroprudential Policy

34. Since the 2008 FSAP, the BCEAO has implemented key elements of WAEMU’s macroprudential policy framework. The Financial Stability Committee of the WAEMU (CSF-UMOA), which was created in 2010, includes all regional financial sector regulators and is charged with conducting regular assessments of systemic risks, recommending macroprudential measures, and ensuring coordination across the various authorities responsible for financial sector oversight.

35. The macroprudential policy framework applicable to banks, introduced in 2010, includes appropriate instruments. These include capital surcharges (e.g., a countercyclical buffer, a conservation buffer, and a systemic buffer) and measures to contain credit growth applied to loans secured by real estate collateral (e.g., ceilings on loan-to-value and debt-service coverage ratios).¹²

¹² The systemic buffer is applied solely to regional systemically important institutions.

weigh risk factors by their relative importance, with a higher weight for concentration risk, given its importance in banks' risk profiles. The robustness and performance of the rating system should be assessed on a regular basis.

40. The resources of the CBU and its secretariat should be strengthened. The SGCB teams are experienced and qualified, but their capacity should be strengthened further to respond adequately to the changing banking sector landscape, including the rising complexity and stronger presence of cross-border groups, which give rise to new risk types. Continued IT investments will be needed to optimize and automate the off-site supervision's toolkit.

41. The supervisory authority's preventive efforts should be accompanied by vigorous deterrent actions. The CBU should strengthen the frequency and intensity of onsite supervision, particularly the inspection of banks' governance and risk management. The CBU has various types of sanctions at its disposal, which it can apply separately or jointly. Yet, it has not been sufficiently strict toward entities that violate prudential regulations over extended time periods, particularly in enforcing the minimum capital requirements. The CBU tends to rely on unpublished written censures and on stays of proceedings—at times used repeatedly. Censures and sanctions should be published to enhance their effectiveness, with monetary sanctions used more frequently. Repeated stays of proceedings should be avoided to the extent possible.

C. Supervision of Money Laundering and Terrorism Financing Risks

42. Despite important reforms to enhance the supervisory framework for anti-money laundering/combating the financing of terrorism (AML/CFT), significant weaknesses persist. The CBU has made important reforms to its AML/CFT supervisory program following the adoption of a new Uniform Law in 2015 and the issuance of implementing regulations in 2017. These include the introduction of a new overall supervisory risk assessment model that assigns risk ratings to each bank, the administration of an AML/CFT-specific bank questionnaire, and the issuance of updated onsite inspection checklists.¹³ Yet, significant weaknesses persist: (i) the offsite supervision program for AML-CFT is underdeveloped and not fully risk based; (ii) the AML/CFT-related inputs to the risk assessment model are unduly limited; (iii) the AML/CFT onsite inspection program requires methodological improvements in certain key areas, including to distinguish between lower- and higher-risk domestic politically exposed persons (PEPs); and (iv) the CBU does not cooperate effectively with key partners in and outside the region.

43. The authorities should undertake further steps to fully implement the AML/CFT supervisory program based on a risk-based approach and enhance supervisory capacity. These include: (i) expanding the role of offsite supervision and moving to a risk-based model; (ii) requiring banks to submit, at least annually, basic clientele statistics to serve as additional ML/TF risk indicators, including on the number of foreign customers and high-risk domestic PEPs, and residents of higher-risk regions or countries; (iii) strengthening the onsite inspection program by enhancing the methodology with respect to politically exposed persons, suspicious transaction reporting, and

¹³ The risk ratings include global ratings and ratings specific to Money Laundering and Terrorism Financing (ML/TF).

CRISIS MANAGEMENT AND BANK RESOLUTION

48. A bank resolution framework has been established but not implemented; yet already nonviable institutions need to be promptly addressed. The framework was introduced in 2015 but has not been put into practice, despite the presence of several banks that have been in serious violation of prudential regulations or under provisional administration for several years, with no prospect of returning to viability within a reasonable timeframe. The framework is quite comprehensive but should be extended to include liquidation in the resolution toolkit and appropriate safeguards for creditors in resolution. Importantly, undercapitalized, nonviable credit institutions that should be promptly liquidated or resolved.

49. The priority for the Resolution Board is to finalize banks' resolution plans. The publication of the regulatory texts in 2020 has permitted banks to begin preparing preventive resolution plans. The CBU's approval of the initial resolution plans for systemic institutions and financial corporations is ongoing, but the authorities need to complete the review of these plans without further delay and ensure that they are supported by reasonable funding arrangements to ensure their credibility. The urgency of preparing the resolution plans and establishing dialogue with relevant foreign resolution authorities require mobilizing adequate resources at the CBU.

50. The decision-making independence of the key stakeholders in the financial safety net should be strengthened. This relates to: (i) the independence of the CBU Resolution College relative to the Supervisory College and to national authorities; and (ii) the independence of the FGDR, with respect to active members of the banking industry. As for the Supervisory College, the review of appeals against decisions of the Resolution College should be reserved for WAEMU's Court of Justice, which has legal competency to determine their legality.¹⁴

51. The availability of funding resources for bank resolution should be strengthened. The systemic institutions' loss-absorption capacity appears inadequate, requiring further efforts to ensure availability of liabilities that can absorb losses in the event of resolution without threatening financial instability. The FGDR's reserves are insufficient to contribute to resolution funding without compromising its key mandate of guaranteeing deposits in case of liquidation. Accordingly, an ambitious strategy is needed to accelerate the FGDR's ability to attain a reasonable target for coverage of eligible deposits with available reserves. A recourse mechanism should also be established to enable the FGDR to tap member states' resources for resolution funding or reimbursement of insured depositors in case of liquidation.

¹⁴ Actions of the Court of Justice should not result in the reversal of measures taken by the resolution authority, in line with [FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions, 5.4-5.5](#).

FINANCIAL SECTOR DEVELOPMENT¹⁵

52. A multipronged strategy, mindful of financial stability implications, should be developed to improve access to finance. The lack of adequate SME funding opportunities is a key impediment to inclusive growth. Financial access could be improved via: (i) more efficient debt enforcement procedures; (ii) further effort to extend the credit bureaus' information; and (iii) steps to foster competition in the financial sector. Competition-enhancing measures should establish a level playing field across private and public banks, with formal analyses assessing regulatory impact on competition conditions, conscious of possible adverse financial stability implications. Finally, social security institutions, which manage close to 5 percent of regional GDP, could play a more active role in developing the capital market as institutional investors.

53. The WAEMU has established a solid regional payment system, but further steps to foster use of novel payment methods would be beneficial. The payment system has been functioning well. Yet, further digitalization of retail payments would help reduce transaction costs relative to the mostly cash-based economy and improve welfare, including for poorer populations. Several national treasuries in the WAEMU region plan to issue electronic money to better serve populations with limited access to digital financial services and to accelerate the availability of public sector funds. The legal framework governing the payment system should be revamped to support new payment methods and operators, including fintech firms, and to protect customers and safeguard financial integrity.

54. The governance of public banks should be strengthened to increase their contribution to economic development in the Union. Public banks play a minor role in the region, accounting for a small proportion of financial sector assets. Yet, they can play an important role for funding underbanked segments, such as SMEs—a role that requires a refocusing of their traditional business model. Compliance issues with prudential regulations, including capital adequacy, persistently experienced by some public banks should be addressed decisively.

55. The authorities should adopt a green strategy for the financial system to address risks and development challenges. The strategy should establish a dedicated governance structure and mobilize commensurate resources. It should focus on developing adequate capacity for evaluating the impact of climate risks on the financial system, and on establishing outreach among supervisors and financial institutions. In the medium term, supervisors should define their prudential expectations on the inclusion of climate risk in financial institutions' risk management and disclosure frameworks. They should also develop a uniform taxonomy for green assets and reach out to financial institutions to seek out their commitment to the WAEMU's and the Paris Accord's climate goals and encourage issuance of green sovereign debt to stimulate the green finance market.

¹⁵ Further details could be found in the technical notes prepared by the World Bank in the context of this FSAP.