

## 2005 Joint Review of the Programme Aid Partnership

### Input for Aide Memoire from the Financial Sector Working Group

3rd Draft – April 19, 2005

#### Executive Summary

1. **2004 Performance:** For the Financial Sector, the PAF 2004 identified 8 targets related to 5 actions for 2 objectives. The FSWG has rated the GoM's performance against PAF 2004 indicators as **Fairly Good**. The progress has been rated good for 4 targets, fair for 2 targets, and poor for 2 targets. The targets and their ratings are given below. For the four targets where the rating was poor or fair, it is expected that the target will be met during 2005.

<i>PAF 2004 Action and Target</i>	<i>Performance</i>
Forensic audit of BAU started	Fair
Strategy and timetable for IFRS in the financial sector prepared	Good
Regulations for LICSF (Banking Institutions Law) prepared	Good
LFL (Law for Bankruptcy) submitted to parliament	Poor
Withdrawal of GoM participation in BAU initiated	Good
Strategy for state withdrawal at BIM defined	Fair
Strategy for public company participation in financial sector developed	Poor
New Chart of Accounts for Insurance Sector prepared	Good

2. The FSWG was not able to conclude on the GoM's performance against the two broader objectives. While the supervision capacity of Banco de Mozambique continues to be reinforced, there is limited information to assess whether there has been improvement of financial intermediation especially for micro, small and medium enterprises. In order to address this issue the FSWG will obtain the necessary information for the next review and will also propose new indicators for 2006.
3. **Future prospects / Issues:** The PAF 2005 identifies 5 targets for the 4 actions related to 3 objectives (an objective related to improvement of the insurance and pensions sectors was added). Progress to date on these targets is mixed. Some targets may be met during 2005 while others could be delayed to 2006.
4. The FSWG has begun working on defining new objectives, actions and indicators for PAF 2006. These will be linked to the strategy identified in the GoM's five year plan. The FSWG will develop 10-12 actions that will be submitted for inclusion in the 2006 PES and a subset of 5 actions that will be proposed for inclusion in the 2006 PAF.

#### Introduction

5. For the 2005 JR, there have been changes to the FSWG. There are new focal persons from GoM side (Joanna David, BoM) and from the development partners (Simon Vanden Broeke, DFID and Ravi Ruparel, World Bank). The membership of the group has also expanded with new members – from GoM, development partners and civil society.

## Assessment of Performance in 2004

6. *Performance against PAF indicators / targets:* The performance against the PAF 2004 indicators is rated as *fairly good*. The progress has been rated good for 4 targets, fair for 2 targets, and poor for 2 targets (see Table 1). For the two targets where the rating was fair it is expected that the target will be met during 2005. For the two targets where the rating was poor, the target may not be met in 2005.
7. *Performance against 2004 PAF objective:* The FSWG was not able to conclude on the GoM's performance against the two broader objectives. While the supervision capacity of Banco de Mozambique continues to be reinforced, there is limited information to assess whether there has been improvement of financial intermediation especially for micro, small and medium enterprises. For the JR 2006, the FSWG will obtain the necessary information to assess the performance against objectives.
8. *Performance against other commitments:* In the Financial Sector the GoM has also made commitments to the IMF (see Table 2) and the World Bank (see Table 3). Many of the actions/ commitments are similar to the PAF actions. (E.g. transition to IFRS, divestiture from BIM). However there is one specific commitment under the IMF's PRGF that is not in the PAF. This is the establishment of a Financial Investigations Unit: This benchmark for December 2004 was not met. The GoM has developed an action plan and timetable and expects to have the unit established by December 2006 (with assistance from the AfDB under the FSTAP).

## Sub Sectoral Performance and Issues

9. *Banking:* There have been efforts made to strengthen banking supervision. A new inspection manual is being drafted and models for applying the regulation on consolidated supervision are being developed. There has been an increase in the number of staff and a draft of a new regulation on the assessment of, classification, and provisioning of loans is being prepared. During 2004, the banking sector showed an improvement in capital adequacy indicators and asset quality indicators. However, while interest rates fell and the spread decreased, there was no increase in private sector credit.
10. *Micro and Rural Finance:* The sub sector has shown continued growth in terms of outstanding portfolio (approx. USD 18 million as at December 2004). However this is more due to an increase in average loan sizes (nearing USD 300) as the number of credit clients has been growing only moderately and reached approx. 60,000 at the end of 2004. Savings mobilization has developed positively, especially since the market leader (NovoBanco) has intensified its efforts and has around 15,000 savings accounts. The sector has seen a concentration in market shares with the top 3 providers NovoBanco, Socremo and Tchuma currently accounting for approx. 80% of the outstanding portfolio. Geographical expansion of the big MFIs is gaining momentum and new branches are being opened in the Central and Northern provinces as increased competition in Maputo forces the MFIs to look at other provinces to grow and reach economies of scale. Development of new products has been mainly driven by the market leaders NovoBanco and Socremo, which already offer housing loans, consumer credits, money change services and national as well as international money transfer. NovoBanco is planning to introduce ATM services for its clients. Interest rates for credit clients have remained steady at around 3-5% per month for microclients depending on credit size and risk.

*c. Insurance:* In 2003 total insurance coverage (life and non-life) was around 1.1 billion MZM (approx 1.1% of GDP).<sup>1</sup> The non-life sector dominates the Mozambican insurance market with 77% of total insurance coverage in 2003. In 2004 there has been continued increase in non life cover particularly for automobile, fire and personal policies. The insurance market has 5 companies and 15 insurance collectors (brokers/agents) with the state owned EMOSE accounting for over 50% of the market share.

### **Future prospects and Issues**

11. *PAF 2005:* The PAF 2005 identifies 5 targets for the 4 actions related to 3 objectives (an objective related to improvement of the insurance and pensions sectors was added). Progress to date on these targets is mixed. Some targets may be met during 2005 while others could be delayed to 2006. (see Table 4)
12. *PAF 2006 :* The FSWG has begun working on defining new objectives, actions and indicators for PAF 2006. The FSWG will develop 10-12 actions that will be submitted for inclusion in the 2006 PES and a subset of 5 actions that will be proposed for inclusion in the 2006 PAF.
13. *Link to GoM Strategy:* The objectives, actions and indicators for the 2006 PES and PAF will be linked to the following financial sector objectives described in the GoM's five year plan. :
  - modernize the expansion of the financial system;
  - reinforce regulation and supervision and reduce vulnerability that might affect the financial system;
  - encourage and promote entry of new financial institutions therefore increasing competition and diversifying products of the financial market
  - promote measure to expand the banking services for better regional coverage with emphasis to the rural areas;
  - continue with actions towards contribution to the growth of national savings;
  - promote the emergence of credit institutions specialized in micro-finance;
  - increase the degree of monetarization of the national economy;
  - adopt international accounting standards;
  - expand financial services in rural areas
  - develop financial services accessible to the medium enterprises & family aggregates;
  - Improve a insurance services and social protection

### **FSWG Activities:**

14. *Frequency of Meetings:* In the past the FSWG has only met twice a year at JR and MTR. During the meetings for the JR 2005, the FSWG has decided to meet more regularly (every 3 months). These meetings will be coordinated by Joanna David and Simon Vanden Broeke. The current composition of the FSWG is provided in Table 6.
15. *Objectives of meetings:* During the April 2005 meeting, the FSWG agreed that future FSWG meetings will be used to :
  - track performance against PAF indicators;
  - discuss sectoral issues;

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<sup>1</sup> THIS FIGURE NEEDS TO BE CHECKED BY IGS/AFDB

- used to monitor performance against indicators which are in the PES but not the PAF;
- develop new objectives, actions ,and indicators;
- discuss approaches to obtain the information required in the Joint Review with regard to performance regarding gender, HIV/AIDS and to provide a province/district perspective;
- share information regarding TA project activities (see Table 5 for the current design of the Financial Sector Technical Assistance Project FSTAP).

**Table 1: Performance against PAF 2004 Indicators**

<i>Objective</i>	<i>Action</i>	<i>PAF 2004 Target</i>	<i>Actual Performance</i>	<i>Performance rating</i>
Reinforce the supervision capacity of the Banco de Mozambique	Carry out a forensic audit of BAu (coordinated by BoM for the AG's office)	Start audit	The audit has not yet started. Contract negotiations are ongoing with Lebouf (of RSA) who will have KPMG (of RSA) in their team.	Fair
	Implement IFRS in the financial sector (including harmonization of taxes) <sup>2</sup>	IFRS strategy presented	Diagnostic studies of 4 banks (BIM, BAu, BSTM and BCI/CF have been completed.  A strategy and timetable for transition to IFRS was prepared in March 2005.	Good
Improve financial intermediation including that directed to the micro, small and medium enterprises and family aggregates without access to commercial banks	Strengthen institutional capacity of BoM and other regulatory authorities	Regulations related to the LICSF (Banking Institutions Law) prepared.	Banking regulations were approved and issued (Dec 2004)	Good
		LFL (Law for Bankruptcy) submitted to parliament	Microfinance regulations were approved and issued (Dec 2004) 1 LFL was drafted but has not yet been submitted to parliament. [May depend on commercial code]	Poor
	Withdrawal of Government as a shareholder in the banking sector	Withdrawal of participating in BAu initiated.	Withdrawal of participation in BAu completed.	Good
		Strategy for state withdrawal at BIM defined.	Strategy is being developed.	Fair
Reform of Insurance Sector	Chart of Accounts prepared	Chart of accounts has been prepared and published. Ministerial diploma nr. 113/2004 or 23 June 2004.	Good	

<sup>2</sup> This is interpreted to mean considering the implications on taxes.

**Table 2: IMF PRGF 2004 Structural Performance Criteria and Benchmarks (for Financial Sector activities only)**

<i>Action</i>	<i>Type</i>	<i>Due Date</i>	<i>Status</i>
Complete a feasibility study on the divestment of the government's participation in BiM	Performance Criteria	Dec 2004	Delayed; Revised date is Sep 2005
Complete the revision of the regulatory framework for microfinance activities	Benchmark	Sep 2004	Done
Developed timetables to move gradually to IFRS and to comply with loan classification and provisioning based on international best practices	Benchmark	Dec 2004	Timetable for transition to IFRS completed in March 2005
Issue regulations of the anti-money laundering law and establish financial investigations unit.	Benchmark	Dec 2004	Regulations issued; FIU not yet established

**Table 3: World Bank PRSC 2 Benchmarks (for Financial Sector activities only)**

<i>Sector</i>	<i>Benchmark (PRSC 2 – for 2004/2005)</i>	<i>Status</i>
Banking	Financial Institutions Law approved	Done
Banking	Diagnostic reviews completed; Action plans prepared for transition to IFRS	Done
Banking	GoM will divest of shares held in trust for BAu employees	Done
Insurance	Action plan for making insurers IFRS compliant will be implemented	Not begun

**Table 4: PAF 2005 Targets and status as at April 2005**

<i>Objective</i>	<i>Action</i>	<i>PAF 2005 Target</i>	<i>Status</i>
Strengthen accountability in the banking sector	Carry out a forensic audit of BAu through the AG's office	Finalize audit	Audit is expected to take 6 months. If contract is signed in April/ May, the audit may be completed in 2005.
Improve financial intermediation including that directed to the micro, small and medium enterprises and family aggregates without access to commercial banks	Strengthen institutional capacity of BoM and other regulatory authorities	Approval and issue of LFL legislation. <sup>3</sup>	The legislation is being drafted. AfDB will provide assistance under FSTAP. Legislation likely to be submitted for approval in 2006.
	Withdrawal of Government as a shareholder in the banking sector	Implementation of BIM strategy. GoM interest brought to point of sale.	Strategy is expected to be developed by September 2005. Implementation may not be completed by December 2005.
Improve insurance and social protection sectors	Improvement of social protection system	Submission of social protection law to parliament	The social protection law being reviewed. It is not clear when it will be submitted to parliament. The regulation for private pension funds will be prepared after this law is approved.
		Beginning of actuarial study of social security system	The actuarial study will begin in 2006. Assistance will be provided by AfDB.

<sup>3</sup> This was wrongly stated in the PAF 2005 as approval and issue of LICSF regulation.

**Table 5: FSTAP Components (indicative)**

<i>Component</i>	<i>Implementing Agencies</i>	<i>Funding / TA</i>
Strengthen Banking Sector	Bo M, DNIA, IFB	World Bank, DFID, IMF (MFD)
Strengthen BoM	BoM	World Bank, IMF (MFD)
Public Debt Management	MoF	World Bank, Sweden
Money Markets and Foreign Exchange	BoM	World Bank, IMF(MFD)
Lending Environment (Legal / Judicial)	UTREL, MoF	AfDB
Insurance	IGS, Emose	AfDB
Pensions	IGS, INSS	AfDB
Micro & Rural Finance	MoF, BoM	KfW, GTZ

**Table 6: FSWG Composition**

<i>Government of Mozambique</i>	<i>International Partners</i>	<i>Civil Society</i>
Joana David (BoM) Otilia Santos (MoF) Domingo Jose (IGS) Isaltina Lucas (MoF) Sarmento Senda (INSS), Luis Matsinhe (??), Albano Manjate (¿?)	Simon Vanden Broeke (DFID) Ravi Ruparel (World Bank) Lars Ekman (Norway) Anton Johnston (Sweden) Patrick Elmer (Swiss Cooperation) Carsten Sandhop / Karim ould Chih (Germany) Julius Schlotthauer (USAID) H Malate / T Adeniji (AfDB) Francisco Carrerras (EU)	?? (CTA) ?? (Ambancos) Adriano Frey (Caldeira & Associados)