

**Gabon: Financial System Stability Assessment,
Including Reports on the Observance of Standards and Codes on
the following topics: Monetary and Financial Policy Transparency,
Banking Supervision, and Insurance Regulation**

This Financial System Stability Assessment paper on **Gabon** 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 **March 15, 2002**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the Government of **Gabon** or the Executive Board of the IMF.

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GABON

Financial System Stability Assessment

Prepared by the Monetary and Exchange Affairs and African Departments

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March 15, 2002

- The Financial System Stability Assessment report is based on the joint IMF-World Bank mission that visited Gabon from May 31-June 5, 2001, and June 26-July 10, 2001, as part of the Financial Sector Assessment Program (FSAP). The mission met with the Bank of Central African States (Banque des Etats de l'Afrique Centrale, BEAC), the Banking Commission of Central Africa (Commission Bancaire de l'Afrique Centrale, COBAC), the Ministry of Finance, the Secretariat of the Regional Insurance Supervisory Council (Conseil Régionale de Contrôle des Assurances, CRCA), and representatives of the private sector.
- The team was comprised of Carlos Cuevas (Head, World Bank), Anne-Marie Gulde-Wolf (Deputy Head, IMF), Samir Abhyankar, Linda Desscan (Team Assistant), Eric Haythorne, Gregorio Impavido, Alain Laurin, Korotoumou Ouattara, and Andre Ryba (all World Bank), Karl Driessen, Felix Fischer, and Ludvig Soderling (all IMF), and Marcel Maes (formerly Belgium Banking Commission).
- The Gabonese financial sector is dominated by a relatively sound but small banking sector that focuses squarely on the formal sector. The operating environment is characterized by a fixed peg to the euro, heavy dependence on oil exports, and continued government presence in both the enterprise and financial sectors. The mission's findings include the following challenges to financial stability: (i) minimum regulatory solvency ratios are low, and even relatively minor changes in macroeconomic variables could put individual institutions at risk; (ii) the continued exposure of banks to public enterprises and to Government suppliers indicates that declines in fiscal revenues—for example due to oil price declines and/or the shrinking output level—can have a negative impact on banks; (iii) in the medium term, with a shrinking oil economy, pressures are likely to emerge that will require structural adjustment in the banking sector; and (iv) despite recent progress, several significant deviations from best supervisory practices remain, in particular insufficient staffing of the regulatory agency, contributing to continued problems in off-site supervision.
- The report is divided into two sections. The first section presents the main findings and overall stability assessments, while the second section provides summary assessments of standards and codes in the areas of banking and insurance supervision, and monetary and financial policy transparency, as inputs into the overall assessment. These assessments were conducted in collaboration with the regional institutions in which Gabon is a member (BEAC, COBAC, and CRCA), and pertain to the practices as they apply to Gabon. The FSAP report, on which this report is based, includes the detailed background analysis and covers developmental issues.

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SECTION I. STAFF REPORT ON FINANCIAL SECTOR ISSUES

I. OVERALL STABILITY ASSESSMENT

1. The major macroeconomic and structural factors affecting the short- and medium-term stability of the financial sector include: (1) Gabon's membership in the Central African Economic and Monetary Community (Communauté Economique et Monétaire de l'Afrique Centrale, CEMAC) with a common currency fixed to the euro; (2) a production structure based on oil and, to a lesser extent, forestry products and manganese, with oil output projected to decline markedly over the next five years; (3) an overall relatively sound but small banking system focused on the formal sector of the economy; and (4) a strong role of the Government in both the enterprise and financial sectors.
2. Against this background, the major challenges to financial sector stability identified through simulation exercises of possible shocks and through a critical review of the applicable regulations include the following:¹
 - Gabon's banking sector, which dominates financial activity, has been overall resilient and profitable. This notwithstanding, solvency levels in some institutions are close to the forthcoming regulatory minimum of 8 percent (effective in 2004). Stress tests show that even relatively minor changes in macroeconomic variables could put individual institutions at risk. This risk is exacerbated by the banking sector's portfolio concentration. With few domestic interbank relations there are, however, no indications that there might be contagion across banks. When problems occurred in the past, the authorities have been quick in putting into liquidation banks that required it.
 - Fiscal problems have in the past had direct and indirect negative repercussions on the performance of the financial sector. The continued exposure of banks to public enterprises and to government suppliers indicates that declines in fiscal revenues—for example due to oil price declines and/or from the shrinking output level—can have a negative impact on banks.
 - A high level of liquidity and adequate access to central bank refinancing facilities seem capable of containing banking sector risks in the short term. In the medium term though, with a shrinking oil economy, pressures are more likely to emerge and will

¹ The analysis in the report is for the most part based on data for end-2000 or February 2001, the latest data made available by the authorities. Information on important structural developments and on the recapitalization of a bank previously below minimum capital is reflected in the report.

probably require structural adjustment in the banking sector, including through diversification, internationalization, and improvements in risk monitoring.

- There are significant deviations from best supervisory practices, although the regulatory framework is overall well developed and the COBAC, the regional supervisory agency, is recognized for its efficiency and professionalism. The COBAC's resources, in particular staffing, remain inadequate, contributing to continued problems in off-site supervision. The prospective increase in the regulatory minimum capital requirements (from 5 to 8 percent by 2004) appears too low, given the operational risks in the economy. Money laundering regulations are also not in place, although the authorities are developing harmonized legislation in this area.
- Deficiencies in the wider legal and regulatory framework pose a threat to financial sector activities. There is a need to ensure consistency between national and regional laws and regulations. All such laws and regulations, including the OHADA Uniform Acts, must be disseminated more broadly and applied more consistently. Increased efficiency, transparency, and predictability in the disposition of financial sector litigation would reduce risks and costs. These results, however, will require a significant increase in funding for Gabon's judicial system.

3. Given Gabon's income level and medium term prospects, the major developmental challenge is to foster a financial sector that contributes to more broad-based economic growth, while allowing an extension of financial services beyond the narrow formal sector currently covered. It will be important though that supervisors are mindful of the risks that could be implied in institutions' growth strategies and apply adequate monitoring. Important institutional and regulatory issues should also be clarified and supervision improved to promote longer-term savings, e.g., through life insurance, pensions, and capital markets, and to ensure soundness of the institutions concerned. Regarding capital markets, the arrangements currently proposed should be reviewed to assess their economic viability and sustainability.

II. MACROECONOMIC AND FINANCIAL CONTEXT

4. Gabon is a member of the six-country Central African Economic and Monetary Community (Communauté Economique et Monétaire de l'Afrique Centrale, CEMAC). The CEMAC members share a common currency, the CFA franc, which is issued by the Bank of Central African States (Banque des Etats de l'Afrique Central, BEAC), and which is pegged to the euro. Banking supervision in the region is undertaken by a common supervisor, the Central African Banking Commission (Commission Bancaire de l'Afrique Centrale, COBAC). Fiscal policy is the key instrument at the disposal of the Gabonese authorities, as membership in the monetary union and the requirements implied in maintaining the fixed exchange rate restrict the use of monetary tools. In this framework, fiscal policy slippages tend to manifest themselves in government arrears and in foreign reserve losses.

5. An oil-rich and politically stable country, Gabon has a nominal per capita GDP of about US\$4,000, far exceeding the levels of the other CEMAC countries. Nevertheless, Gabon faces serious macroeconomic and structural challenges. Over the past two decades the dependence on oil exports has also led to uneven growth performance and significant macroeconomic instability. Efforts to shield consumption from income losses following oil price declines, along with ambitious infrastructure projects, led to rapid build-up of external public debt over the 1980s and early 1990s. Problems in servicing the external debt have led to the build-up of significant external arrears, with Gabon largely losing access to international capital markets. At the same time, domestic public sector arrears, including to the financial system, have also increased. Gabon's recent adjustment efforts have been supported by an IMF Stand-By Arrangement.

6. The policy challenges for the future are greatly aggravated by current output projections in the country's oil industry. Based on known oil stocks, production levels are expected to decline by about 50 percent over the next five years, leading to sharp declines in fiscal revenues and the flow of reserves for all but the most favorable assumptions about oil price developments. Given the lack of a broader economic base, the short-term possibilities to cushion the decline in oil output are limited. In addition to oil, the economy relies on only two other export products, wood and manganese. Although Gabon has vast renewable forestry resources, export growth in this sector, even in light of the ongoing diversification toward final wood products, is unlikely to fully offset the drop in oil exports.

A. Financial Sector Characteristics

7. The financial sector in Gabon is overall profitable and stable, but in relation to the size of the economy and per capita income, it remains relatively underdeveloped (Box 1). The defining characteristics of the sector are:

- Gabon's banks—which dominate the financial sector (Table 1)—find their activities and growth potential limited by the size of the non-oil economy, given that financing of the oil sector is largely undertaken outside of the country. Lending restrictions imposed by foreign parent banks also contribute to the institutions' focus on a relatively narrow segment of business. Commercial banks are cost efficient and liquid, while questions remain about their capitalization.² There are relatively weak links between banks and other financial institutions, with the exception of finance companies, which, however, tend to be wholly owned subsidiaries of banks (see Table 2).

² At the time of the mission, one bank (BNCR) was under interim administration. It is currently under liquidation. Since this report discusses the 2000-01 situation, statistics include the BNCR as a state-owned bank.

Box 1. Gabon: Main Characteristics of the Financial Sector

The Gabonese financial sector consists of six commercial banks, two savings banks, two securities firms, six finance companies and six insurance companies. There are only minor activities in the microfinance sector.

The level of financial intermediation in Gabon is low relative to other developing countries. For 1999, credit to the private sector represents 10.7 percent of GDP (or 17.2 percent as a percentage of non-oil GDP), compared with 27 percent in Kenya, 57.5 percent in Mauritius and 69.3 percent in South Africa. Deposits to GDP in Gabon amount to only 12 percent, compared with 36.8 percent in Kenya, 74.2 percent in Mauritius and 55.4 percent in South Africa. It is not clear to what extent the shallow financial system is caused by Gabon's economic structure, in particular, the large share of (generally foreign-financed) oil exploration. While Gabon and Venezuela do share low levels of private sector credit to GDP (10.1 percent, 10.6 percent), other oil-producing economies including Iran (20.5 percent), Cote d'Ivoire (17 percent), Libya (26 percent), Kuwait (55 percent), Qatar (35 percent) and Saudi Arabia (30 percent) do not share the same characteristics.

The banking sector dominates the financial system, with banking sector assets accounting for about 90 percent of total assets. Within the banking sector, the three largest banks, the Banque Internationale pour le Commerce et l'Industrie du Gabon (BICIG), the BGFIBANK (BGFI) and Union Gabonaise de Banque (UGB) together hold more than 80 percent of deposits and loans, with BICIG alone accounting for more than 40 percent. The remaining banks are Citibank N.A. Gabon and Banque Gabonaise de Développement (BGD). The Banque Nationale du Crédit Rural (BNCR) has recently been put under liquidation. The Government has a majority shareholding in BGD and BNCR and significant participation in three other banks. Citibank is a branch of Citibank New York, and 56.2 percent of UGB's capital is owned by Credit Lyonnais. In BICIG, the Banque Nationale de Paris (BNP) and the Société Financière d'Outremer (a subsidiary of BNP) together control 46.7 percent of capital. One bank has a branch and a subsidiary abroad. Commercial banks employ about 1,200 people.

Security firms and finance companies together account for 4.8 percent of the system's total assets. Life and non-life insurance companies account for 7.1 percent of the total assets of the financial system, or 1.9 percent of GDP. There are 13 microfinance institutions, serving about 2,700 clients. This sector as a whole had only about 700 outstanding loans in 2000.

Table 1. Gabon: Financial System Structure

Type of Institution	Number of Institutions					Total Assets	
	Dec-31 1996	Dec-31 1997	Dec-31 1998	Dec-31 1999	Dec-31 2000	Dec-31 2000 (CFAF millions)	Dec-31 2000 (In percent of GDP) 1/
Depository Institutions:							
Banks 2/	8	8	8	8	6	789,766	22.1
Savings banks 3/	2	2	2	2	2	48,483	1.4
Mortgage institutions 4/	1	1	1	1	0	0	0.0
Credit unions, cooperatives, microfinance institutions 5/	n.a.	n.a.	n.a.	17	13	n.a.	n.a.
Non-depository intermediaries							
Securities firms 6/	2	2	2	2	2	1,938	0.1
Finance companies 7/	n.a.	n.a.	4	5	6	44,230	1.2
Life insurance companies 8/	n.a.	n.a.	n.a.	3	2	14,951	0.4
Non-life insurance companies 9/	n.a.	n.a.	n.a.	4	4	52,366	1.5
Social Security Fund 10/	1	1	1	1	1	38,416	1.1
							Percentage of banking system's assets
Memo items:							
Banks with majority shareholder(s) (more than 50 percent)							
State banks	2	2	2	2	2	72,256	9.1
Domestic private banks	0	1	1	2	1	190,395	24.1
Foreign banks	5	4	4	4	2	231,922	29.4
Of which are subsidiaries	3	2	2	2	1	126,528	16.1
Of which are branches	2	2	2	2	1	105,394	13.3
Banks with significant state participation 11/	5	4	5	5	5	684,372	86.7
Banks with significant foreign participation 12/	6	5	5	4	3	527,115	66.7

Source: COBAC, Gabonese authorities (DNA), annual reports of finance companies.

1/ Calculated on the basis of a nominal GDP for 2000 of CFAF 3,577 billion.

2/ In 2000: BGD, BGFI, BICIG, BNCR, CITI, UGB. In March 2001, BNCR was put under interim administration; in January 2002, it was put into liquidation.

3/ PCC and CEP. Total assets are overstated because (a) CEP has a 7 billion deposit in CCP, and (b) CCP has a suspense account of CFAF 25 billion.

4/ Credit Foncier du Gabon is a government refinancing institution not open to the public.

5/ 2000 number as per end of June.

6/ In 2000: SONADIG and BGFI Participation are registered with COBAC. There are some 10 non-registered and non-supervised security firms with marginal sizes.

Assets reported refer to BFGI Participation. Data on SONADIG is not available.

7/ In 2000: BGFIBAIL, FINATRA, INTERFI, SOGABAIL, SOGACA, BICIBAIL.

8/ Axa Life Insurance and Ogar Life Insurance. Assets as of December 1999.

9/ ASSINCO, AXA, OGAR, ANG. Assets are as of December 1999 and exclude ANG.

10/ The Social Security fund covers health benefits, family allowances, working injury compensation and pensions. 50 percent of the assets are financial assets. For the purpose of this report, these assets are not included in the financial sector's total assets.

11/ In 2000 the government had 26.4 percent in BICIG, 28.7 percent in UGB (of which 3.7 through BGD), 25 percent in BGFI (of which 15 percent through BGD), 69.0 percent in BGD and 74.1 percent in BNCR.

12/ In 2000 significant foreign participation were in BICIG (BNP 23.8 percent and SFOM—an affiliate of BNP—22.9 percent), Citibank (100 percent) and UGB (Credit Lyonnais 56.2 percent).

Table 2. Gabon: Measures of Financial System Interconnectedness
(As of December 31, 2000)

	(In millions of CFAF; percent of system capital 1/)	
1. Banking system connected lending (exposure)		
On-balance sheet 2/	41,761	44.6
Off-balance sheet	n.a.	
2. Banking system equity investments in:		
Financial institutions	7,171	7.7
Nonfinancial institutions	1,702	1.8
3. Banking system lending (exposure) to:		
Finance companies	26,278	28.1
Securities firms	40	0.0
4. Gross (overnight) interbank lending (exposures) to		
Domestic banks	8,074	8.6
Foreign banks	...	0.0
5. Banking system exposure to insurance sector		
Credit	131	0.1
Equity and others	265	0.3
		(Percent of system deposits)
6. Insurance sector deposits in banking system		
Sight deposit	3146	0.6
Time deposit	17,636	3.4

Source: COBAC

1/ Capital as defined by COBAC.

2/ BICIG accounts for CFAF 29.5 billion, of which CFAF 25.3 billion is a loan to the Government. The government's share participation in BICIG is 26 percent. Exposure to non-government shareholders in the banking system is marginal and amounts to CFAF 150 million.

- The government retains a strong role in the financial sector, both as owner and as client, either directly or through public enterprises. The government has majority shareholding in two, and significant shareholding in another three banks. In total, banks accounting for more than 85 percent of assets are subject to some government ownership. The possibility of government arrears, either to banks or to suppliers who are bank clients, are an important determinant in portfolio quality.
- There are few formal financial institutions other than those in the banking sector. Leasing and insurance companies—most of the latter in a precarious financial situation—exist but are not of systemic importance. Microfinance institutions, prevalent in other African economies, are insignificant in Gabon, leaving a large part of the population outside of the formal and informal financial system. Government efforts have not been successful in widening the scope of financial services. Efforts to promote broader access to credit and financial markets—for example through the BNCR and FODEX—have failed.

B. Prudential Environment

8. The resilience of a country's financial sector to shocks depends on its initial soundness, the magnitude of the shocks, as well the quality of the regulatory environment that would assure prompt and appropriate responses to financial sector stress. Gabon's credit institutions are supervised by the COBAC. While national authorities impose the minimum required paid-in capital, the COBAC sets a minimum risk-weighted capital-asset ratio, and regulates liquidity, risk diversification, and maturity transformation. Recently, it started requiring that interbank lending be risk weighted according to a CAMEL rating system (see Box 2) and government debt to be weighted according to compliance by governments with the four macroeconomic convergence criteria set up under the monetary union. Insurance companies are supervised by the Regional Insurance Supervisory Council (Conseil Régionale de Contrôle des Assurances, CRCA), while insurance intermediaries are supervised by the National Insurance Directorate (Direction Nationale des Assurances, DNA).

9. Soundness and performance indicators, as monitored by the COBAC, show that credit institutions as a whole are relatively healthy. Gross non-performing loans (NPLs) relative to total assets averaged 3.5 percent over the past five years, peaking at 4.4 percent in December 1998.³ As of December 2000, gross NPLs to total assets were 3.6 percent.⁴ Provisions for doubtful loans were on average 62 percent and range between 35 to 80 percent across banks.

10. In spite of the overall favorable assessment, there are important differences in individual banks' compliance with prudential ratios. At end-February 2001, out of five fully operating banks, only one complied with all prudential ratios. Two banks were not adequately capitalized,⁵ three did not meet the risk diversification requirements, and two held (marginally) insufficient liquidity.

³ For the purpose of the analysis, non-performing loans are defined as guaranteed and non-guaranteed loans for which payment has not been made for a 90 day period, and correspond to the COBAC's classifications of *créances douteuses, litigieuses et contentieuses*.

⁴ One bank currently has NPLs in the range of 23 percent of total assets; however, part of these was acquired at a discount from a failed institution.

⁵ The capital adequacy ratio of one bank was below 5 percent, and of another bank below 8 percent; these banks subsequently increased their capital to around 8 percent.

Box 2. CEMAC: Recent and Prospective Changes in Prudential Regulations for the Banking System

The COBAC has recently adopted new regulations with respect to the solvency ratio, provisioning, and connected lending. Other regulations are currently under discussion, in particular, regulations with respect to internal control and audit. The main changes that have been implemented or are still forthcoming include:

- *Solvency Ratio (capital adequacy ratio):* Starting in 2001, bank assets are divided into groups of 0, 20, 50, 75 and 100 percent of risk weight. Interbank lending will be risk-weighted according to the Sysco rating system (see below). Government debt is weighted according to compliance by governments with the four macroeconomic convergence criteria set up under the monetary union. Furthermore, loans to companies that have obtained a classification agreement from BEAC confirming their financial strength are risk weighted at 50 percent. Under the new regulation, the regulatory solvency ratio will be increased from five to eight percent in annual steps, starting in 2002.
- *Provisioning rules:* In 2000, formal provision rules have been introduced. Only required provisions are tax deductible. There are no provisioning requirements for late payments of up to 90 days, but accrued interest cannot be recorded as interest income. Provisioning rules for payments late by 90 days or more are:

	First Year	Second Year	Third Year	Fourth Year
Uncollateralized and nonguaranteed loans	25 percent	75 percent	100 percent	100 percent
Collateralized or guaranteed loans	15 percent	45 percent	75 percent	100 percent

- *Sysco Rating:* In 2000 COBAC introduced a CAMEL rating system for commercial banks. Under this new system (the Sysco rating), capital counts for 30 percent, quality of the portfolio for 20 percent, quality of management and internal control for 20 percent, earnings for 10 percent, and liquidity for 20 percent. Banks are rated into four groups. Rating one stands for solid banks, two for banks with a good financial situation, three for fragile banks and four for banks that are in a critical situation. In 2001, the banks' scores were communicated to the banks' management only. In 2002, the scores will be shared amongst all the banks, and in 2003, COBAC intends to make the rating public.
- *Connected lending, large exposure and coverage of fixed assets:* Procedures have been established with respect to the granting of loans to the banks' shareholders, associates, managers and employees. Total connected lending has been limited (as per 1/1/2002) to 15 percent of capital. With respect to large exposure, the limit has been set to 45 percent of capital for an individual client, and 800 percent of capital for the total of large exposures (loans larger than 15 percent of capital). Banks' fixed assets cannot exceed eligible capital (*fonds propres net*).

III. SHORT-TERM VULNERABILITIES

11. This section reviews the extent to which there are short-term risks to financial sector stability in Gabon. It also reviews whether financial sector developments could pose an immediate threat to macroeconomic stability. The overall findings show that short-term risks exist, especially for specific institutions with relatively low solvency ratios. However, the system as a whole seems capable of withstanding a significant deterioration in interest and exchange rates. Liquidity risks and threats to macroeconomic variables seem contained. Table 3 provides selected financial sector soundness indicators for the banking system; Table 4 contains the aggregate balance sheet of banks.⁶

A. Exposure to Interest and Exchange Rate Shocks

12. Interest and exchange rate changes are the macroeconomic variables that generally have the most immediate effect on banks' balance sheets.

- In the short run, Gabonese banks' exposure to interest rate risk appears to be limited as most assets and liabilities have short maturities. A stress test simulating a 100-basis-point increase in interest rates shows that the system as a whole will be able to withstand such an increase (Table 5). An increase in lending and borrowing rates of 100 basis points would result in a cumulative loss of CFAF 4.2 billion and a reduction in the system's solvency ratio from 13.3 percent to 12.7 percent.⁷
- Banks, however, have different exposures to interest rate risk, with at least one bank significantly more exposed. Using the same assumptions, the solvency ratio of the most affected bank would fall by 2.0 percentage points. As this bank's solvency ratio is around the regulatory minimum, the small increase in interest rate simulated would cause its solvency ratio to fall below the prospective prudential limit. In contrast, the solvency ratio of another bank would make a net gain of 1.5 percentage points.

⁶ Although the oil sector plays an important role in the Gabonese economy, there are few direct linkages with the financial sector, since production and exploration are financed from abroad. Indirect effects in the medium term, through sustained oil revenue declines, are discussed in Section IV.C.

⁷ Stress tests are conducted to simulate possible shocks, but they are not meant to be forecasts. The interest rate stress test quantifies the potential loss (or gain) banks may face on the present value of their interest sensitive assets and liabilities because of an increase (or decrease) in the prevailing interest rate as a result of their inability to re-price assets and liabilities instantaneously.

Table 3. Gabon: Financial Sector Soundness Indicators
(In percent)

Camels Indicators	Dec 31 1996	Dec 31 1997	Dec 31 1998	Dec 31 1999	Dec 31 2000	Feb 28 2001
Capital adequacy						
Tier-1+2 capital/assets 1/	n.a.	n.a.	25.2	23.0	13.5	12.5
Asset quality						
Loan (or exposure) concentration						
Large exposures/total capital 2/	n.a.	n.a.	8.8	0.0	25.7	28.5
Connected lending/total capital 2/ 3/	n.a.	n.a.	0.1	0.3	0.5	0.6
Sectoral loan concentration (as percent of total loan): 4/						
Forestry	7.1	3.3	4.4	4.3	9.3	11.9
Mining and oil	14.0	12.2	6.7	3.4	4.3	4.8
Industry	8.7	8.2	11.8	6.9	1.1	0.6
Construction and public work	11.5	10.0	10.9	7.2	6.6	6.8
Domestic trade	15.3	16.8	18.1	14.4	17.6	16.6
Services	18.3	16.9	16.3	40.4	26.0	23.1
Individuals	15.4	17.4	21.2	15.9	33.8	35.5
Foreign currency lending						
Foreign exchange loans/total loans 5/	n.a.	n.a.	n.a.	n.a.	22.2	n.a.
Nonperforming loans						
Gross NPLs/total gross loans 6/ 7/	5.1	4.8	8.7	9.4	6.6	7.6
Gross NPLs/total capital 2/, 6/	n.a.	n.a.	32.9	39.2	41.7	12.6
Management						
Expenses/revenues	43.1	39.5	43.8	45.5	39.5	n.a.
Earnings/employee (in million CFAF) 8/	n.a.	n.a.	n.a.	84.3	n.a.	n.a.
Earnings						
Return on (average) assets 9/	n.a.	5.2	4.9	4.3	5.2	n.a.
Return on (average) equity 10/	n.a.	68.9	60.4	52.0	69.0	n.a.
Interest margin/gross income	46.8	48.5	45.7	49.5	43.9	n.a.
Noninterest income/gross income 11/	36.2	35.8	36.1	31.4	39.4	n.a.
Liquidity						
Liquid assets/total assets	26.3	12.3	15.1	15.6	25.4	20.1
Liquid assets/short-term liabilities	68.9	35.8	46.2	46.3	56.9	54.7
Funding volatility ratio 12/	15.7	24.9	20.6	21.5	25.6	20.8
Short term deposits/total liabilities 13/	36.5	32.2	30.8	32.0	42.5	34.1
Sensitivity to market risk						
Net foreign exchange position/total capital 2/ 14/	n.a.	n.a.	n.a.	n.a.	96.7	n.a.

Source: COBAC, BEAC.

1/ Until December 31, 2000, all assets were risk-weighted by 100 percent. Since January 1, 2001, a new regulation has been introduced with variable risk weights. Time series only include banks still operating in year 2000. Definition corresponds to COBAC's *ratio de solvabilité*.

2/ Capital as defined by COBAC (*fonds propres nets corrigés*).

3/ Connected lending excluding loans to the government.

4/ Except for 2000 and 2001, the numbers include outstanding loans of previously closed banks. Data for 2001 are as of December 31, 2001.

5/ Foreign exchange loans include loans from mother company. Total loan include interbank lending.

6/ Gross non-performing loans include the part of the loan that has been provisioned for (equivalent to the following categories of COBAC: *Créances douteuses, contentieuses, impayées + provisions*).

7/ Total gross loans include the part of NPL that had been provisioned for (equivalent to COBAC's categories: *Crédits à la clientèle + Débiteurs divers + Provisions*).

8/ Including management.

9/ Return on average assets is defined as pretax net income of the year as a percentage of average assets of the year (t) and year (t-1).

10/ Return on average equity is defined as pretax net income of the year as a percentage of average equity of the year t and t-1.

11/ This ratio is constructed from balance sheet items and differs from COBAC's liquidity ratio.

12/ Funding volatility ratio = (volatile liabilities - liquid assets) / illiquid assets.

13/ Excluding interbank deposit.

14/ Net foreign exchange position excludes off-balance sheet items.

Table 4. Gabon: Aggregate Balance Sheet of the Banking System
(In millions of CFAF and in percentage of total assets; December 31, 2000)

Assets		Share of Total	Liabilities and Capital		Share of Total
Cash and balances with central bank	57,049	7.2	Refinancing with BEAC	280	0.0
Government securities	35,955	4.6	Refinancing with others	21,937	2.8
Loans and advances to banks	188,826	23.9	Deposits by banks, financial institutions, and branches	94,961	12.0
Loans and advances to customers	414,388	52.5	Deposits by clients	524,971	66.5
Of which:			Of which:		
Short term	91,977	11.6	Short-term	255,839	32.4
Medium term	188,433	23.9	Government	255,839	32.4
Long term	11,759	1.5	Public enterprises	80,159	10.1
Overdrafts	109,715	13.9	Of which:	6,729	0.9
Nonperforming loans (net) 2/	10,105	1.3	Time deposits	215,591	27.3
Leasing	932	0.1	Government	25,116	3.2
Securities	14,692	1.9	Public enterprises	16,782	2.1
Of which:			Accruals and other liabilities	10,158	1.3
Shares in affiliates	9,131	1.2	Provisions	18,527	2.3
Fixed assets	40,945	5.2	General reserves for loans and other risks	6,413	0.8
Accruals and other assets	36,979	4.7	Other reserves	43,432	5.5
			Subordinated liabilities	0	0.0
			Capital 1/	93,667	11.9
			Profit for current year	30,845	3.9
Total assets	789,766	100.0	Total liabilities	789,766	100.0
Off-balance sheet items:			Bank guarantees issued	102,699	13.0
State guarantees	0	0.0			
Other guarantees received	144,120	18.2			

Source: COBAC.

1/ Capital as defined by COBAC.

2/ Non-performing loans net correspond to gross non-performing loans minus provisions on non-performing loans.

Table 5. Gabon: Results of the Stress Tests 1/

Status	Credit Risk			Foreign Exchange Risk		Interest Rate Risk	Profitability Projection
	Scenario A 2/ 5 percent increase in NPLs	Scenario B 3/ Increase in NPLs to turn capital negative	Scenario C 4/ Deterioration in forestry sector	Scenario D 5/ 40 percent euro/\$ appreciation	Scenario E 6/ 40 percent CFAF/euro depreciation	Scenario F 7/ 1 percent rate hike	Scenario G 8/ Nonpayment on government debt
12/31/2000							
Number of banks with solvency ratio below five percent 9/	1 out of 5	3 out of 5	2 out of 5	2 out of 4	2 out of 4	2 out of 5	
Solvency ratio banking system	13.3% (11.3% ^{9/})	9.2%	10.1%	5.9% ^{9/}	13.5% ^{9/}	12.7%	
Gross NPL/total assets	3.6%	14.2%					
Impact on ROA							-0.3%

1/ Stress test analysis is based on supervisory (non-consolidated) data solvency ratios (COBAC) for 12/31/00. In some cases, banks do not agree with COBAC calculations of solvency ratios.

2/ Scenario A estimates the impact on banks' balance sheet of loan portfolio deterioration of 5 percent of loans becoming non performing, assuming that provisions are made of 75 percent for NPLs.

3/ Scenario B estimates the increase in NPLs that would lead to Tier I plus Tier II capital turning negative, assuming provisions are made at 75 percent.

4/ Scenario C estimates the impact on banks' balance sheet of 40 percent of forestry related credits and 20% of transportation related credits turning non performing, assuming provisions are made at 75 percent.

5/ Scenario D estimates the impact on solvency of a 40 percent appreciation of the euro (and euro-pegged) currencies vis-à-vis other currencies.

6/ Scenario E estimates the impact on solvency of a 40 percent depreciation of the CFAF vis-à-vis all currencies (including the Euro).

7/ Scenario F estimates the impact on solvency of a 1 percent increase in lending and borrowing rates.

8/ Scenario G estimates the decrease in return on assets (ROA) resulting from the government falling into arrears on commercial bank debt.

9/ Due to limited availability of data, solvency ratios for scenario D and E only comprise four banks. The overall capital-adequacy for these four banks equals 11.3 percent.

- Gabonese banks have at times shown a tendency to expose themselves to significant foreign exchange risk.⁸ At end-December 2000, four of the five Gabonese banks were maintaining long foreign exchange positions—defined as foreign exchange assets greater than foreign exchange liabilities. The cumulative net long position in non-euro denominated currencies approximates CFAF 45 billion, while the cumulative net long position in euro amounts to close to CFAF 35 billion.
- An appreciation of the euro vis-à-vis the US dollar and the British pound would have near balanced effects on the banking system as a whole, given that foreign exchange holdings are diversified between the two currency groups. However, the portfolio structure of the least capitalized bank differs significantly from the average, exposing it to the risk of falling below regulatory minimum capital as a result of a return of the US dollar/euro exchange rate to its 1999 level.

B. Liquidity Risk

13. Insufficient liquidity, or the lack of access to liquidity support, could also pose important short-term risks. At present, though, liquidity risk in Gabon seems contained.
- Liquidity of the banking sector as a whole far exceeds regulatory requirements. In addition supplementary sources—such as the regional interbank market, which Gabonese banks successfully tapped during a liquidity squeeze in 1998, and access to the BEAC money market—are available. Against this background, possible negative liquidity shocks, such as payment delays on Government debt that have occurred would not pose any immediate threats.
 - The noncompliance of two banks with the prudential liquidity ratio (at end February 2001) was more indicative of a lack of regulatory pressure than signaling an inability to comply. Both institutions have since reached the regulatory minimum.
 - For solvent but illiquid institutions, safeguard arrangements are in place. The BEAC has a lender of last resort facility that allows banks to access the money market without collateral. At the discretion of the Governor, lending under this facility can, for a limited time period, exceed the national rediscount ceiling.

C. Risks from Fiscal Developments

14. Given the role of the government in Gabon's economy, an important macroeconomic risk to financial sector stability lies with the implementation of fiscal policies. In the past,

⁸ There are no *prudential* regulations limiting open positions. However, banks are only permitted to hold foreign exchange balances for current operations on behalf of clientele. The calculations of the net open position are based on the on-balance sheet exposures only.

fiscal policy slippages have resulted in government arrears to the banking sector and to banks' clients.

15. Ongoing adjustment efforts undertaken as part of the Fund program were designed to maintain the room under the statutory ceiling at the central bank at the equivalent of 3 percent of GDP during 2001. In the event, fiscal slippages eroded much of this margin during the year. In this light and of the planned gradual reductions in the BEAC statutory ceiling, there is a need to strengthen public finances and reduce its indebtedness vis-à-vis the banking system, so as to avoid renewed arrears to banks and suppliers, with the attendant direct and indirect effects on banks. Beyond a one-year horizon, important medium term risks persist (see Section IV). The introduction of a sound public debt management strategy, which would include the planned Treasury bills, would help mitigate such risks.

D. Possible Threats to Macroeconomic Stability from Financial Sector Developments

16. Gabon's membership in a monetary union limits the most immediate short-term macroeconomic risks from financial sector weaknesses. Such risks would generally work through uncontrolled liquidity support for weak financial institutions, which could be reflected in monetary expansion, inflation and/or sharp increases in interest rates. The institutional framework set by the BEAC, while providing adequate lender of last resort facilities, has institutional safeguards in place that prevent uncontrolled liquidity support. Other macroeconomic effects of financial sector weaknesses—such as budgetary costs for bank restructuring, are relevant in Gabon's case in the medium term, as discussed in the next section.

IV. ASSESSMENT OF MEDIUM TERM RISKS

17. This section reviews medium term challenges faced by the Gabonese financial sector. While only a subgroup of the risks is directly quantifiable (see the credit risk scenarios below) other challenges may have equally serious repercussions. Efforts to address all the risks listed below would appear necessary to ensure medium term financial sector stability.

A. Credit Risk

18. In the medium term, the viability of the financial sector critically depends on its ability to withstand swings in credit quality. A series of stress tests was performed to review the systems' resilience to credit risk.

19. A first approach in stress testing credit risks is to assess the extent to which solvency of the banks is impacted by future provisioning needs, arising from a recession-induced increase in non-performing loans. The following effects appear likely to result from an increase of gross NPLs to total assets of 5 percentage points for all banks (Table 5):

- For the system as a whole, an increase in gross NPLs from roughly 3 percent (level of December 2000) to 8 percent of total assets will cause the banking system's solvency ratio to fall from 13.3 percent to 9.2 percent.
- Given the sharp differences in the solvency ratio of Gabonese banks, under the assumption of a 75 percent provisioning rate, such a shock would lead to three banks falling below the COBAC's 5 percent required capital adequacy ratio, while it would leave two banks relatively unaffected. The combined impact on the five banks would be a charge against capital of CFAF 28 billion.

20. A second scenario estimates the percentage increase in NPLs that banks would be able to absorb before their net equity (fonds propres nets) would turn negative.

- The banking system as a whole could absorb an increase of NPLs to total assets of 14.2 percentage points before its net equity turns negative.
- The net equity of the three most vulnerable banks, however, would become negative with increases in NPLs of between 3 and 8 percentage points of total assets. One bank could absorb an increase in NPLs of close to 13 percent of total assets, while a public sector bank, which is currently extremely highly capitalized, could absorb roughly three quarters of its total assets turning non-performing.

21. Given the large exposure of the banking sector to the forestry sector, a third scenario focuses on the effects of an external demand shock, reducing demand and world prices for Gabon's forestry output, including for the more diversified final products that increasingly complement the exportation of raw logs. The scenario assumes that 40 percent of forestry-related credits and 20 percent of transportation credits—which largely are subsidiary to forestry production—become non-performing. The effects of such a shock would be as follows:

- The banking system as a whole would be able to withstand this shock, with overall solvency ratio declining from 13.3 to 10.1 percent. Total non-performing loans in the banking system would increase from 2.9 percent to 6.9 percent of total assets. Non-performing loans for the bank with the largest exposure to forestry-related credits would increase by 7.8 percentage points.
- However, the above result hinges critically upon one bank, which is currently very heavily capitalized. The solvency ratio of the other four of the five operating banks would fall to or below the 5 percent minimum, thus underscoring the exposure of the sector in this area.
- To the extent that banks have lent to other financial intermediaries that are exposed to the forestry and transportation sectors (including to leasing companies), deterioration in these sectors is likely to further worsen the position of these banks.

B. Risks Related to Banking Sector Characteristics and Portfolio Structure

22. The following structural features of Gabon's banking sector could contribute to medium term solvency or growth problems, unless adequate safeguards are put in place:

- Gabon's banking sector is highly concentrated. The largest bank accounts for more than 40 percent of loans and deposits, and the largest three banks account for more than 80 percent of all bank loans and deposits.⁹ While the banking structure and, hence, the degree of concentration is due to the characteristics and size of the economy, the effects of the market structure require monitoring. The main potential risk associated with the high degree of concentration relates to possible inefficiencies and slower innovation arising from the lack of competition as well as the danger of problems in one bank taking on systemic importance. To avoid negative effects from high concentration requires stronger banking supervision and adequate consumer protection laws.
- The banking sector's loan portfolio is non-diversified. At end-February 2001, three out of the five operating banks did not meet prudential ratios on risk diversification, leaving the sector as a whole exposed to a small number of enterprises. Furthermore, sectoral loan concentration—an equally significant problem given Gabon's narrow economic base—is insufficiently monitored by banks.
- The Government continues to play a dominant role in the banking sector, with all but one bank in partial or full state ownership. This, together with a pervasive role of the Government as a bank customer—both directly as well as through state owned enterprises—creates moral hazard due to widespread belief in implicit state guarantees. Also, past banking crises in the region have in most cases been caused by government interference in loan decisions.¹⁰

C. Challenges Related to the Decline in Oil Revenue

23. The projected decline in oil production in Gabon is likely to have a profound impact on the economy. While some of the effect might be cushioned by favorable changes in oil prices and/or the euro/US dollar exchange rate, an overall trend of a declining oil income is likely. Possible financial sector effects include the following:

⁹ In a forthcoming IMF study on financial sector consolidation covering 105 countries, the mean three-bank concentration ratio was found to be 51 percent (of assets). The top three banks had a market share of greater than 80 percent of assets in less than 10 countries.

¹⁰ In contrast to other countries in the region, liquidations of banks in Gabon did imply some depositor losses.

- Government revenues and spending might decline, causing a downward trend in the economy. Unless compensated by growth in non-oil sectors, for example through increased domestic activity following privatization of state enterprises, this depression of activity could lead to system-wide problems in servicing loans.
- A fiscal scenario in which government expenditure reductions would fall short of what would be implied by the shrinking economy points to the risk of reemergence of significant government payments arrears. While these might affect the banks directly, for example through non-payments on interest due on rescheduled government debt, the main effects are likely to be indirect, as suppliers and other government creditors default on bank debt, after not having been paid by the government. In such a scenario, particularly public enterprises and banks might suffer, as they would be less well prepared to cut relations with the government as a result of non-payment.
- Foreign interest attracted to Gabon as a result of oil exploration might wane. This could include expatriate workers, which tend to be an important presence in the formal financial sector, as well as foreign institutions that have come to the country to provide specific services related to the oil economy. Financial institutions—while not directly lending to the oil sector—might be indirectly affected, and could reduce their business interests in the country as a result.
- The decline in the oil industry, through public finances or other channels, may also lead to pressure on foreign reserves in the context of a fixed exchange rate regime, with the attendant effects on credibility and other indirect effects on financial sector stability.

D. Regulatory and Supervisory Risks

24. The COBAC is a successful supervisor with a recognized track record in analyzing banking sector problems and taking corrective measures in the case of failing institutions. Its supervisory effectiveness has first been assessed in the context of the 2000 Cameroon FSAP. Based on the results of this first assessment, the COBAC has proposed new draft regulations and made other changes to adapt its supervisory practices (Box 2).

25. The updated assessment of the COBAC's compliance with the "Core Principles for Efficient Banking Supervision" undertaken in conjunction with the present FSAP for Gabon confirms a high degree of professionalism for the supervisor and a significant degree of compliance with the Core Principles.¹¹ Notwithstanding the overall positive assessment, the review reveals the following concerns with possible effects for the Gabonese financial sector:

¹¹ See Section II.I for a Financial Sector Summary Assessment of the Basel Core Principles.

- An overriding problem for the COBAC, impacting on its ability to comply with a number of core principles, relates to insufficient staffing of the institution. In the past, the lack of staff has contributed to weaknesses in off-site supervision. Unless adequately addressed, other improvements in the regulatory framework are not likely to lead to the desired outcome. The lack of resources should be addressed before the institution is given new tasks, such as, for example, the supervision of microfinance.
- A weakness in the present supervisory framework relates to the insufficiently developed framework for off-site supervision that is only partially compensated by adjustments made during on-site inspections. In this area, the COBAC has recently started preparing draft regulation on internal and external audit. While these regulations are welcomed, there is a risk that, in the absence of a global increase in resources for the COBAC, the improvements in off-site supervision might be achieved at the cost of less stringent on-site control.
- There is currently no specific control over market and foreign exchange risks. Given that Gabonese banks are internationally active and most engage in foreign exchange operations, risks in these areas exist. While a regulation of foreign exchange positions is planned in the near future, no specific plans exist yet regarding the regulation of market risk.
- The required solvency ratio will increase stepwise from 2002 to 2004 from 5 to 8 percent, but even the new ratio will not make any allowance for operational risks. Such risks, as for example inefficiencies in Gabon's judicial system, are prevalent and would suggest higher capital requirements than the minimum suggested by the Basel Committee. The production structure of the economy—which allows for little portfolio diversification—also increases the risk of shocks, with potentially significant negative effects on banks.
- There are no regulations pertaining to money laundering and banks have not yet been given guidance with respect to identifying suspicious customers and transactions. As part of the licensing process, the COBAC is to verify the sources of funds for new banks, but this requirement falls short of supervising the operations of existing institutions. Inadequate attention to money laundering would leave the region open for potentially serious reputational risks. As a first step, the authorities have set up a working group to develop harmonized anti-money laundering legislation and regulations for the CEMAC region.
- There is limited transparency of banks' operations, given that they are not subject to well-defined disclosure requirements. The authority to require this currently rests with the BEAC, but should be transferred to the COBAC to allow the supervisor to regulate the information flow from banks to the public, which is part of the overall supervisory framework.

26. The main conclusions of the assessment of the IAIS Core Supervisory Principles are the following:¹²

- Insurance regulation is of high quality. However, several issues have been identified and should be addressed in the short to medium term. Most companies pertaining to the region of the Inter-African Conference of Insurance Markets (Conférence Interafricaine des Marchés d'Assurances, CIMA) have limited retention capacity and have serious difficulties in respecting the regulation on coverage of policy liabilities. The CRCA should quickly be put in the position to supervise reinsurance activity while companies should be allowed to invest in liquid and tradable assets abroad. This should be tied to implementation of appropriate requirements on foreign exchange matching.
- The effectiveness of insurance supervision in the region is limited because of an acute lack of resources in terms of budget, personnel, skills, and information technology, both at the CRCA and national (DNA) levels. This is compounded by problems of conflict of interests and excessive political pressure inherent to the specific composition of the CRCA and the Council's technical committee. The CRCA should develop a more transparent and formal supervisory process with automatic triggers to impose sanctions. At the national level, the Gabonese DNA should abandon paper-based information and develop appropriate information technology to conduct off-site supervision. Finally, it should be authorized to supervise the commercial relationship between companies and brokers with the aim at reducing the occurrence of premium arrears.

E. The Legal and Regulatory Infrastructure

Legislative framework

27. Good progress has been made in putting in place a regional legislative and regulatory framework that is broadly appropriate for the establishment and operation of commercial banks, other financial institutions and insurance companies in Gabon. References to these frameworks and the observance of standards and principles for supervision of banks, financial institutions and insurance companies were made in the preceding section.

28. In addition, the OHADA Uniform Acts have replaced a number of fragmented laws in Gabon and now govern essential features of financial and commercial transactions and contracts. Issues identified with respect to this legislative framework are: (a) a limited knowledge and understanding of the OHADA Uniform Acts among concerned parties, compounded by an absence of dissemination and training; and (b) a lack of clarity in the

¹² See Section II.III

definition of a number of terms and concepts used in several texts (e.g., the security law and the bankruptcy law).

Judicial system

29. Gabon faces deficiencies in its judicial system, enhancing risks and costs of doing business, including for the financial sector. The following are among numerous problems regularly aired in respect of the judicial sector: (i) the absence of specialized training in matters of commercial, banking and insurance law results in lack of magistrate expertise in adjudicating on these matters; (ii) permitted procedural measures, automatic rights of appeal and significant backlogs of cases in all courts create long delays, such that foreclosing on mortgages, for example, can take up to five years; (iii) lack of published jurisprudence and of learned commentary results in courts rendering inconsistent decisions in dealing with similar factual evidence, thereby bringing the law into disrepute; (iv) budgetary resources allocated to the judicial system are inadequate, resulting in poor infrastructure and working conditions; (v) as of July 2001, strikes in the courts of Gabon had been ongoing for four months resulting in the postponement of litigation and the registration of documents with Court Clerks in respect of secured interests; and (vi) allegations of favoritism and corruption are voiced throughout the public sector.

F. Financial Safety Nets and Crisis Management

30. Crisis management procedures for both liquidity and solvency crises in the CEMAC region seem adequate. However, with respect to solvency the COBAC follows a case-by-case approach with no fixed rules defined. The existence of such rules would increase the transparency of the process and protect supervisors from political interference.

31. With respect to liquidity, banks have, in addition to the regular refinancing from BEAC against collateral, access to additional funds from BEAC in a crisis situation (see also section II). These arrangements are well documented and provide the BEAC with the possibility to support solvent but illiquid banks. Contact with the COBAC in such a case would ensure the solvency of the institution, as well as steps towards improvement in liquidity management in the bank in question to prevent reoccurrence of the liquidity problems.

32. There is at present no deposit insurance in the CEMAC region. A draft proposal has only been ratified by two countries. With significant banking sector problems continuing in at least one member country of the region, indications are that the introduction of the system will not proceed for a while.

33. Notwithstanding the absence of formal deposit insurance, the four liquidations of banks in Gabon since 1997 have not led to pronounced spillover effects to the remainder of the system. The authorities have usually moved swiftly to put banks in liquidation when the financial situation warranted it. BNCR, which was insolvent and had a large nonperforming

portfolio, was put under liquidation in January 2002. However, authorities have not shown the same diligence in closing long-running liquidations (BGL, BPGC and BCCI).

34. Abstracting from a recent voluntary liquidation, and the liquidation of the housing bank (CREFOGA), all other liquidations implied some depositor losses. The procedure followed to compensate depositors—generally the smallest depositors were reimbursed in full while larger depositors were compensated out of recovered assets—seems adequate and it would appear to have contributed to minimizing the possibility of contagion to other banks. The effect of deposit losses for large depositors was also contained by the fact that these were generally not deposits of individuals, but most often of public enterprises.

V. POTENTIAL LONGER-TERM RISKS AND NECESSARY SUPERVISORY RESPONSE

35. The notion that effectively functioning financial systems generate economic growth is now broadly accepted and supported by solid empirical research. In addition to the transfer of funds in exchange for goods, services and promises of future return, financial institutions (broadly defined) perform several key economic functions that contribute to long-term growth primarily by improving factor productivity. Increasing financial depth, therefore, is a desirable objective. At the same time, it should be recognized that financial growth strategies could carry the seeds for future instability. Adequate forward-looking supervisory action is needed to provide the appropriate prudential framework for durable growth.

36. One of the major problems of commercial banks in Gabon is the shallowness of the market and their difficulty to expand domestically. This prevents adequate risk diversification within the current market framework and could pose problems over time for financial sector stability if banks were to pursue excessively risky growth strategies. Two avenues for expansion are open to the banks: (a) diversifying domestically by entering into unserved markets; and (b) proceeding with cross-border expansion. Two banks have given some weight to the first approach by spinning off subsidiaries. But, like their parents, these subsidiaries to date focus on selected segments of the population. Other banks have developed debit cards to give access to some limited financial services to a larger part of the population. Three banks either have expanded, or are in the process of expanding, outside Gabon while remaining within the CEMAC region. An alternative to opening a subsidiary abroad is to syndicate loans with foreign banks. These trends should be closely followed by supervisory authorities.

37. The payments system does not by itself pose any systemic risk owing to its small size and the reliance on cash transactions, despite the antiquated clearing system. However, in its present stage it imposes large inefficiency costs on the economy and requires urgent modernization. BEAC has taken the lead in developing a new architecture based on three main pillars: (a) a settlement system in real time (RTGS) for large transactions; (b) a teleclearing system for mass payments; and (c) the development of debit and credit cards. The full implementation of the new payments architecture should greatly improve the efficiency of national and regional banking operations.

38. The insurance sector in Gabon is small and of shallow penetration yet constrained in growth by the overall size of the market. It is essentially linked to economic activity directly or indirectly related to the oil industry, a factor that introduces a long-term risk for the viability of the insurance sector. The insurance market, however, represented only about 7.1 percent of total financial assets in 1999 and it does not constitute a cause of systemic risk to the rest of the financial system.¹³

39. Nevertheless, long-term stability of insurance activity would be elusive if the prudential and operating framework of insurance companies did not allow for improved viability, including through: (i) updating the CIMA code to authorize the supervisory authority to monitor the reinsurance activity of companies; (ii) increasing profitability; (iii) allowing a portion of the reserves, with a ceiling of, say, 20 percent, to be held outside the CIMA region, provided that companies engage in adequate currency matching; and (iv) improve companies' lax recovery practices for premium arrears and poor services provided by local brokers.

40. Pensions are embedded in the social security system in Gabon, which is at present experiencing serious financial difficulties and is in need of reform. The present approach is a "pay-as-you-go" system, which does not contribute to long-term savings, and could pose a long-term threat to financial sector stability through deteriorating public finances. A comprehensive reform towards a fully funded system based on defined contributions and accompanied by prudential supervision and oversight would be needed to overcome the current shortcomings and assure stability in the growth process.

41. A feasibility study for a regional financial market conducted in 1999 concluded that a stock exchange encompassing all six CEMAC countries would be viable after five years.¹⁴ However, no unanimous agreement was reached on the location of the exchange, even though five countries favored locating the exchange in Libreville. Since then another CEMAC member has set up its own exchange, which could attract a large part of the business in the region. Legitimate concerns arise on the viability of any exchange in the CEMAC region that

¹³ Only four non-life insurance companies and two life companies comprise the sector, with total market penetration of just 1.3 percent, of which only 0.18 corresponds to life insurance, i.e., could be counted as long-term savings. The market has two leaders (AXA and OGAR), which are also the only two companies selling life insurance. While this translates into a high level of market concentration, the small population and reduced (and concentrated) economic activity are not deemed capable of sustaining more insurance companies in Gabon.

¹⁴ Questions, however, remain with respect to the fulfillment of minimum preconditions for well-functioning securities markets (including a transparent and fair environment, well-developed accounting, auditing and disclosure standards, corporate rights including rights of minority shareholders *vis à vis* management and majority shareholders, and the efficient enforcement of these rights).

does not include all six countries, jeopardizing stable growth in this segment of the financial sector.