Making Finance Work for Africa (MFW4A) and the African Development Bank (AfDB) convened a Financial Sector Dialogue in Nairobi, Kenya, from 25 to 26 October 2018 to assess the state of play and progress made by Eastern and Southern African countries in support of deepening and broadening the financial sector. The dialogue also aims to address constraints that prevent the financial sector from fully playing its role as a catalyst for growth and in supporting economic and social development objectives, both at the national and regional levels. Among other major outcomes, it is expected that discussions will provide the Bank with relevant information and data to support its 2020-2025 strategy. This high-level meeting was attended by government officials, donors, multilateral financial institutions and the relevant private sector stakeholders.

Discussions around 7 thematics highlighted progress, challenges, and opportunities of the regions' financial sector.

I. Eastern and Southern Africa Financial Sector Landscaping

The Eastern and Southern Africa financial sector landscape has 3 key components: (i) regional payment systems, (ii) the banking system, and (iii) financial inclusion. Two regional payment systems coexist in the regions: The East African Payment System (EAPs) and the Integrated Regulatory Electronic Southern System (SIRES) for the southern region. Technology, which is driving the sector, has brought the unbanked into the banking system. It is viewed by participants as an enhancement, not a disruption of the financial sector.

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1In Tanzania, access to finance increase to 62 percent and to 55 percent in Zimbabwe. In transition states digital such as Somali, 70 percent of the financial access was from mobile money services.
system. Since its introduction in Africa, mobile money has tremendously increased the velocity of money and helped formalize the informal sector. Despite greater access to financial services, the financial sector faces several challenges including; the inadequate regulation and learning by doing attitude. Overall the participants noted that:

- Lack of aligned policies across regulators, cost of banking, currencies compatibility and conversion can be blamed for the lack of financial integration and liquidity of capital markets across eastern and southern Africa (except in South Africa);
- De-risking financial infrastructure required to fully integrate the regions is critical, but this can be achieved through addressing issues such as KYC compliance and abiding to set regulations.
- In order to influence policy positively, the role of data is critical. Large data infrastructure projects to better manage risks should be undertaken and lead by Development Finance Institutions (DFIs) with supports from local governments;
- Governments need also to avoid overregulation of innovation as no one size fits all. The government and the private sector need to work together with banks and other players to define the scope and content of each country set of regulations. Most important is the fact that “innovation comes first before regulation and not vice versa”. While this should be the case, achieving a balance between innovation and regulation is desired;
- Financial literacy is critical towards improving regional integration through the financial sector;
- Having regular central bank meetings with central banks of different economies, can enhance uniformity in regulation that foster cross-border banking, services and trades.

Participants also voiced support for stronger consumer protection regulations to address the unattended consequences of mobile financial services such as over-indebtedness.
II. Strengthening Regional Integration through the Financial Sector

The session sought to present and discuss the status of financial market integration initiatives and regional payment systems.

The EAC had an ambitious agenda/road map for establishing an East African Monetary Union by 2024. However, some countries have not formulated the relevant legislative and policy frameworks. The AfDB has been supporting East African Payment Systems and Settlements. The Bank has worked with central banks to ensure that they had the necessary infrastructure and supported governments to develop the requisite policies during the harmonization process. Currently, Kenyan and Ugandan traders can make payments across banks, even though uptake is still a challenge and requires additional awareness campaigns. The next step is to integrate regional payment systems even though countries are at different levels of development. The recommendation from previous studies was to set up national switches to enable transfer between countries and also setting up of a regional switch. Unfortunately, implementation of capital markets infrastructure has taken a bit longer. Participants identified the following challenges:

i. Inadequate capacity – capacity building should be an on-going process
ii. the integration process is very costly
iii. the decision-making process is a bit slow
iv. consumer awareness is lacking – a financial education strategy has been developed and the EAC is working on a financial awareness strategy
v. there is an emerging risk in retail payments – before the advent of mobile transactions, banks resisted but ten years later, banks are moving towards over-reliance on mobile platform as opposed to using banking cards.

Participants acknowledged the need for additional capacity building aimed at lagging countries i.e. Rwanda and Burundi. Attention should also be paid to other regional integration schemes to get ideas of how to progress with deepening financial integration. In SADC, the rand is already used as a common currency and leapfrogging by using existing digital platforms could be a quick win. However, the cost of using digital platforms is prohibitive and therefore not efficient.

Various issues can also arise with regard to integration due to countries’ different levels of development, including:

i. Non-inclusive discussions: the private sector is key to successful economic integration, therefore a proposed CEO’s forum type of event on integration which would bring up issues of trade infrastructure and push governments to implement the integration agenda.
ii. Large informal sector: Building financial integration should be based on a formal economy but most East African economies are largely informal, with the informal sector contributing more than 80% of employment. There is need to support small scale traders by creating a credit guarantee fund given that most small-scale traders access loans through informal money lenders. Support is also needed to set up a regional centre for data in Africa due to lack of data on SMEs in Africa.

The following recommendations concluded the session:

- To enhance access of financial services, there is need to work on a unique identification number and a centralized database on cross border financial flows within the EAC;
- Both governments and market players should allocate funds towards consumer awareness and financial literacy programmes. Mobile Network Operators (MNOs) and mobile money companies can share infrastructure to reduce costs and a share of the savings can be used to fund financial literacy programmes. Existing platforms such as mobile phone platforms can be used to create financial awareness;
- Interoperability across countries and switches should be effective to reduce the cost of financial transactions. The switch will do channel management, routing of transactions, forex conversion, facilitate processing and authorization of transactions and ensure security of transactions.

III. From Inclusion to Impact – How Does Financial Sector Development Impact the Lives of African Citizens?

One of the challenges in achieving financial inclusions in Africa lies in developing appropriate digital products to meet the needs of the broader population while complying with local regulations. Financial inclusion affects financial services and products and ensures affordability. It also addresses poverty while enhancing growth. Innovation in mobile technology has impacted financial inclusion by providing several services including sending money, paying taxes, bills, etc. It is critical for regional blocs to enhance financial inclusion: SADC has a financial inclusion strategy and EAC projects have among several other objectives to enhance mobility of banks, financial education and establish a regulatory financial strategy.

Though digital payments may address leakages, understanding how the government may be encouraged to use such platform is fundamental. Again, though access is a critical component on financial inclusion, participants wished to understand other metrics available to influence financial inclusion.

There are some risks associated with digital extension of credit. Customer protection is key but how can these have been fully integrated? As institutions make effort to protect depositors, there is need to address information asymmetry: Financial institutions may not be fully aware of what is happening with the customer. Inadequate information about the customer inhibits digital extension of credit. Though some countries like Kenya are more advanced on digital extension of credit, others still lag behind. Other risks identified relate to price transparency, interest rates, regulatory arbitrators, etc. Possible solutions to reducing risks may be through consumer education; this can be done through targeting women and youth. Finally, many economies are not clear on whether to regulate fintechs from telecommunication or banking perspectives.

Several policies can be put forward: allow incentives to go cashless; drive efficiency to serve more people, increase money collected/revenue generated, and reduce cost of providing services. Access should translate to usage of financial services.

IV. De-Risking the Real Economy through Insurance

The real economy is concerned with producing goods and services. There is a significant share of large enterprises producing industrial goods, with many SMEs being in the informal economy. Insurance is mostly forgotten when talking about the financial sector even though it is important because of the existence of risks. Insurance serves two functions: (i) to create an environment that enables efficient way of performing transactions (ii) provides an opportunity to optimize goals. Insurance is the cheapest way of managing risk. Insurance penetration in the regions is low (Botswana: 3%, Burundi:2.8%, Kenya: 2.7%, Tanzania, Uganda: ~1%). Insurance supports economic growth through four pillars (i) the government (ii) the demand side – where customers must be satisfied with the services and must see the perceived value (iii) the supply side – where insurance companies need to come up with products that meet the needs of the people (iv) the general public – that needs to be informed about the value of insurance. Advocacy building and
capacity building are key. The government has not prioritized agricultural insurance, which has mainly been provided by the private sector. However, efforts are being made to push for agriculture insurance and provide coverage for SMEs. However, there is a lot of opportunities for the insurance sector to partner with government especially in agriculture, SMEs and tourism. Participants called for more involvement of governments to expand agriculture insurance.

In Zimbabwe, farmers are given inputs and insured as a group using a weather index. The Ugandan government included a premium subsidy in the budget for farmers, most them growing crops on small parcels of land. There has been increased uptake of insurance in agriculture sector as a result, which has increased yields.

Insurance uptake remains low in Africa mainly due to information asymmetry between the insurer and the end-user. In addition to educating the end users, development programs must include specific regulations designed to ensure customer protection.

With regards to the role of insurance in de-risking infrastructure investments, insurance plays a big role in mobilization of long-term funds. Most political risks are covered by the multilateral organizations (African Trade Insurance agency (ATI)). But insurance companies must be well capitalized.

V. Mobilizing Capital for Climate Change

Africa is the region that has contributed the least to global greenhouse gas emission but it's among the most vulnerable to climate change. Previous estimates place the cost of Africa's adaptation to climate change at between $10 - $30 billion a year by 2030. The section emphasizes on the identification of the climate change mitigation/adaptation strategies in the regions; and to identify sources of finance to fund climate responses developed by those countries in the region.

In many countries climate finance is very much seen in agriculture (financing climate smart agriculture programmes), forest, fisheries and renewable energy programmes but also in education and in defense forces activities. Financing projects or activities that facilitate or foster prevention, adaptation or acquiring new practices and technology that reduce damage to the environment are considered climate finance projects. This also includes financing policy formulation or knowledge development, educational and skills training, and media awareness programmes. The financing comes from international donors, UN agencies, governments and private sector such as banks and other financial institutions.

There are a number of ongoing projects financed under the climate finance agenda in almost all African countries with examples in Tanzania, Kenya, Rwanda, Uganda, Burundi, Zambia, Malawi, Zimbabwe, Namibia, Angola, South Africa, Botswana, Lesotho, Swaziland etc. There are a number of such projects financed and undertaken by developed agencies such as UK Aid, Techno serve, SNV, Oxfam, USAID, and many more. Private sector financing also includes; banks and microfinance programmes on renewable energy, agriculture, livestock, fisheries, forest, mining etc.

Participants highlighted several challenges that affect climate financing in Africa including weak capacity of local institutions supporting climate finance, lack of adequate data required to inform the sector’s growth, larger share of public projects, lack of instruments (climate finance is through loans).

Transiting to green growth projects will require some level of support. For instance, support to SMEs to improve their products to green products. Also, enhancing development of derivatives for climates finance is critical. For example, the carbon credit markets have not yet been effective. Carrying out consumer education especially, the private sector education on climate finance is highly recommended.
VI. Strengthening Eastern and Southern Africa Capital Markets

Liquidity in most African capital markets is generally low and retail depth is also insufficient. One of the challenges is the high cost of government borrowing, which should be controlled to enable investors to seek other investment opportunities. The forex risk is also a big issue. There are also large funds in pension schemes such as National Social Security Fund of Kenya (NSSF) but the money is not being reflected in the capital markets. Many companies are struggling to list on the stock exchange due to their size. These companies require capital development and capacity to grow. Further, capital market developments take a long time, which gives the gap between performance and potential. There is need for enabling policies, especially the capital movement policy. The market structure also needs to be dynamic to embrace the changes. Privatization and issuance of incentives such as tax holidays can potentially increase market dynamism. There is also need to identify and address challenges of simultaneous listing of companies across the EAC.

Participants further reiterated the need for harmonization of capital market requirements across EAC. 13 directives have been issued to amend country-specific laws. However, the roadmap for capital markets did not get full support from all countries with concerns over country’s ownership and control of financial assets.

The cost of raising capital remain high, even though the focus has not been on the development of the bond market despite it being the most liquid market that can lower the cost of capital. There have been discussions around the OTC market, which can absorb large transactions without shocking the market. Scalable transactions and large ticket projects have the potential to attract large investors. Restoring investor confidence should also be priority as some company listings left a sour taste in the mouth of investors.
VII. Financial Sector Development in Post-Conflict: Case of Somalia

The session articulates the participants ideas for a coherent financial sector development agenda and building resilience in transition states. Participants were expected to exchange reviews, lessons and best practices on the ways to improve the process and speed of financial sector development in the post-conflict context.

The financial sector development in Somalia has the following key features:

- Monetary policy is limited, as the economy continues to be highly dollarized. CBS will issue a new currency in the near future.
- Somalia’s financial sector is nascent, and intermediation is limited. Total sector assets are equivalent to about 4.3% of GDP; credit to the private sector is about 1.3% of GDP, although growth has been relatively rapid recently.
- Banks provide a mix of Islamic and conventional financial products. The environment is also challenging; conventional banking service facilities are limited to urban areas,
- Mobile money has received 73 percent penetrations and remittance inflows (20% of GDP) represent opportunities for inclusivity and broad access to financial services. The use of mobile money to conduct cross-border transfers is growing and many Somalis holds balances in MM and MTBs, in addition to traditional savings in banks.

However, a number of progress has been made. Recent reform agenda is broadly favorable with the goal of overhauling the financial sector, enhance monetary and financial institutions operations, and improve the prudential norms. The Overall government reforms includes: enhancing public financial management, fiscal transparency and accountability, and revenue mobilization; strengthening the procurement framework and improving governance; completing Phase I of the currency reform, which consists of exchanging all Somali Shilling currently in circulation with the new national currency; and starting broad-based reforms to spur financial sector development, while strengthening compliance with the AML/CFT; and improving data reporting.

In addition to the progress made through selected reform agenda, the financial sector development has developed a roadmap and has made strides on its implementation. Financial Sector Development in Somalia has in the last three years focused on: First, to build the capacity of the Central Bank of Somalia. Over that period, the fundamentals of banking supervision and regulation have been introduced. Second, to improve the central bank’s functions relating to banking operations, accounting and ICT. Third is to inspect the money transfer businesses’ (MTB) compliance with AML/CFT regulations. Fourth is on supervision of commercial banks, the CBS has approved regulations, including annual relicensing, periodic financial reporting, and defining minimum prudential ratios and lastly to employ inter-bank payment, clearing and settlement systems and other critical market infrastructures needed to improve the efficiency of financial intermediation.

The sector faces numerous constrains to greater financial stability and intermediation. There are considerable trust and information deficits. Financial institutions lack capacity and financial infrastructure (credit information, judicial, legal). In addition, access to credit/finance is usually unfavorable terms and conditions with insufficient collateral for the majority of the public. Further, the payments system is under-developed: Mobile money penetration is high but lacks inter-operability. Moreover, the settlement and clearance of inter-bank transactions does not occur at the CBS in central bank money; and, international payments are largely transacted through MTBs, who face “de-risking” and correspondent accounts challenges. It is evident that
these gaps inhibit more efficient financial intermediation and robust economic growth. There is a great need for regulatory and legal reform in Somalia. Strengthening of the Financial Institutions Law (FIL) is needed in order to improve the legal basis for CBS regulation and supervision of the financial system that is consistent with internationally accepted practice. Also gaps in the AML-CFT framework need to be addressed. A digital ID system is a prerequisite for improving suspicious transaction reporting under the AML-CFT regime and eventual support for efficient lending/intermediation. Finally, de-risking and correspondent accounts challenges continue to inhibit capital in/out flows which has a tremendous impact on the remittance flows and trade financing.

Somalia will require well defined and enforceable property rights and contracts; a collateral or movable asset registry; a financial dispute resolution (bankruptcy) mechanism; developing financial infrastructure to support efficient intermediation is a short-term priority; strengthening capacity (human & institutional) of the sector; developing other financial infrastructure, such as a credit reference bureau and information systems to support decision-making; improved financial reporting and accounting standards and mitigating collateral/credit guarantee issues are also needed to support access to financing.

Participants representing transition states have a common understanding that political crises had a major consequence on the macroeconomics of these country. Political instability made such countries be sanctioned by development partners and the need for reforms was evident. Most countries in similar position were required to revise their national development plan to strengthen the financial sector, the function of the central banks and role of non-bank financial institutions.

The success of such economies requires coordination with all stakeholders both internally and externally. Also, financial sector cannot be strengthened without a stable macroeconomic environment, but with an inclusive stakeholders’ participation. Investment in human capital by training people in diverse professional areas through technical assistance is critical.

Developing the financial sector in post-conflict countries goes beyond developing human capacities on financial literacy and strengthening the legal system. It will also require addressing cost of doing business, improving payment systems, addressing money laundering, insecurity, unfavorable balance of payments to avoid dependence on one sector economy and addressing institutional weaknesses.

Strengthening government support and putting the right intuitions in place also is critical. In fragile economies the government is a major player with the mandate to regulate the sector and ensure its prosperity. For instance, through government support, it is anticipated that mobile money will be a game changer in South Sudan as it will enhance financial inclusion. It is through such payment systems that money will reach local financial institutions and allow central banks to exercise their monetary policy role as well as enhancing financial development.

VIII. Diaspora Investments in Developing African Capital Markets: The case of Zimbabwe DIDG

Diaspora funds are emerging as a source of foreign funding for a country’s development as they can be used to capitalize infrastructure. Diaspora financial flows include diaspora remittances; diaspora direct investments; diaspora investment in capital markets. However, policy has largely focused on diaspora remittances and direct investments. Diaspora remittances are the largest and most visible of the financial flows, and to a lesser but growing extent, financial flows
from direct investments that diaspora entrepreneurs are sending back to their home countries.

Diaspora capital market investments are much less understood and examined but yet offer the biggest source of potential capital to develop African countries in the long term. There is a large potential for capital market investments. The biggest opportunity lies in the ability to mobilize diaspora flows. Globally, it is estimated that the diaspora population is 420 million, with US$ 450 billion estimated financial flows to the countries of origin. In Africa, there are estimated 30 million people in the diaspora with estimated financial flows of US$ 35-40 billion annually.

Remittances are mainly paid from current income sources such as salaries while direct and capital markets investments pool from diaspora savings. Understanding the sources of diaspora capital is critical as it informs the type of capital market instruments that countries, bankers, debt issuers, or people seeking to raise capital from the diaspora can use.

Outline 2: In 2016, 13 Zimbabwean diaspora groups formed the Diaspora Infrastructure Development Group now commonly referred to as DIDG. They embarked on a journey that aimed at aggregating and crowd-funding diaspora capital into the development of Zimbabwe's critical infrastructure. Current members of DIDG amount to over 2,500 with 50% residing in South Africa, 20% in Zimbabwe while the rest are spread across countries such as UK, USA, Canada, Australia, Botswana and Namibia. The group jointly with Transnet of South Africa won the $400m tender to recapitalize the National Railways of Zimbabwe. This recapitalization and rehabilitation of Zimbabwe's railway company is one example of diaspora driving investments into infrastructure development through the semi-privatization of an ailing parastatal and operating it as a private concession for 25 years. The funding structure was based on an ECA backed project finance structure with ECIC providing the political and commercial risk insurance to senior debt provided by the South African and pan African banks such ABSA, Standard Bank, Nedbank, Ecobank supported by DFI's and IFI's such as IDC, DBSA and TDB Bank.

Diaspora members have substantial financial assets beyond their current income, including savings and retirement accounts, real estate property, and investments in stocks and equity, bonds, and other financial instruments. Governments, banks, and businesses in countries of origin have a strong interest in creating financial instruments that can attract these diaspora savings into investments that contribute to sustainable economic development. Such instruments include special deposit accounts in different currencies; trans-national loans e.g. diaspora mortgage facility; securitization of future remittance flows through subscriptions; collective investment schemes such as diaspora mutual funds; diaspora bonds; diaspora equity funds etc.

There are softer issues that need to be addressed when mobilizing diaspora capital. The African diaspora is very skeptical and lacks confidence in governments of their countries of origin being able to appropriately use the capital at their disposal. Demonstration of good governance in the management of diaspora funds is critical when raising diaspora capital. In addition, most diaspora is faced with tremendous asymmetries of information regarding investment opportunities or financial investment instruments in their countries of residence. So, countries wishing to mobilize diaspora capital have to be aware of competition from other foreign financial institutions that wish to attract and tap into diaspora resources.

It is also imperative that countries focus on incentives to attract diaspora capital and also leverage on migrant diaspora networks to bridge the information gap around opportunities that might exist.
Contributions from the floor included experience from Uganda where focus has been on creation of diaspora awareness. The approach has been of taking services to the diaspora, linking them to the government and educating them about available investment options. Further contribution was about the need to focus on diaspora incentives e.g. lower tax rates, waiver of import duty & capital gains tax.