

Financial Sector Development in Post-Conflict: Case of Somalia

“A Financial sector that provides financial stability, intermediation, and inclusive access to financial services is critical to economic growth and poverty reduction.”

OUTLINE

1. Current Situation
2. Progress: Financial Sector Roadmap
3. Challenges
4. Way forward

Current Situation

- I. Monetary policy is limited, as the economy continues to be highly dollarized. CBS will Issue a new currency in the near future.
 - II. 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.
 - III. Banks provide a mix of Islamic and conventional financial products. The environment is also challenging; conventional banking service facilities are limited to urban areas, security is fragile, and a sizable proportion of the population are rural or nomadic.
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- I. Widespread MM use (73% penetration) and remittance inflows (20% of GDP) represent opportunities for inclusivity and broad access to financial services. The use of MM to conduct cross-border transfers is growing and many Somalis holds balances in MM and MTBs, in addition to traditional savings in banks.

Current Situation..Cont' d

- I. **The financial services sector lacks of solid foundations that increase competition.** The lack of regulation for a broad range of financial services (mobile money, insurance) is required to enable level playing.
 - II. **Competitive environment:** Even though the market has several players, the dominance depends on the geography. Additionally, financial service providers are part of economic groups that have several businesses such as banks, telecommunications, money transfer businesses and mobile money. These conditions create invisible entry barriers.
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- I. **Somalis by-pass the financial sector** (there is a gap of formal financial intermediation to meet their financial intermediation needs). Instead they use informal channels to satisfy financial needs: 66% of businesses and 23% of individuals use friends and family to cover financial needs.
 - II. There is a USD 2.2 billion dollars gap between the supply and the demand of financial services in Somalia (debt and insurance).
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- I. **There is little understanding of customer needs.** The financial institutions do not use segmentation and customer information for product development. 64% of businesses and 60% of individuals don't apply for finance because the terms and conditions are not favorable.

Progress: Reform Agenda

- i. 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:
 - The 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;
 - starting broad-based reforms to spur financial sector development, while strengthening compliance with the AML/CFT; and
 - improving data reporting.

Progress: Financial Sector Development Roadmap

- i. Financial Sector Development in the last three years has focused on:
 - i. Build the capacity of the Central Bank of Somalia. Over that period, the fundamentals of banking supervision and regulation have been introduced.
 - ii. Improve the central bank's functions relating to banking operations, accounting and ICT;
 - iii. Inspect the money transfer businesses' (MTB) compliance with AML/CFT regulations;
 - iv. On supervision of commercial banks, the CBS has approved regulations, including annual relicensing, periodic financial reporting, and defining minimum prudential ratios;
 - v. Deploy inter-bank payment, clearing and settlement systems and other critical market infrastructures needed to improve the efficiency of financial intermediation.

While considerable progress has been made, much needs to be done to establish a robust regulatory and supervisory regime. For example, the mobile money (MM) sector is completely unregulated and unsupervised .

Challenges

- I. The sector faces numerous constraints to greater financial stability and intermediation. There are considerable trust and information deficits. Financial institutions lack capacity and financial infrastructure (credit information, judicial, legal).
- II. Access to credit/finance is usually unfavorable terms and conditions with insufficient collateral for the majority of the public.
- III. The payments system is under-developed: MM penetration is high but lacks inter-operability;
- IV. 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.
- V. These gaps inhibit more efficient financial intermediation and robust economic growth.

Challenges...Cont' d

- I. There is 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.
- I. Gaps in the AML-CFT framework needs 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.
- I. 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.

Way Forward

- I. Improved financial reporting and accounting standards;
- II. Somalia will require well defined and enforceable property rights and contracts; a collateral or movable asset registry; and a financial dispute resolution (bankruptcy) mechanism;
- III. Developing financial infrastructure to support efficient intermediation is a short-term priority;
- IV. Strengthening capacity(human & institutional) of the sector;
- V. Developing other financial infrastructure, such as a credit reference bureau and information systems to support decision-making;
- VI. Mitigating collateral/credit guarantee issues to support access to financing.