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Financial Sector Assessment Program
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FSA | Financial Sector Assessment

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GLOSSARY

AML	Anti-money laundering
ATM	Automatic teller machine
BCP	Basle Core Principles
BM	*Banco de Moçambique*
BSD	Bank Supervision Department, BM
BT	*Bilhete do Tesouro*—Treasury bills
BVM	*Bolsa de Valores de Moçambique*—Mozambique Stock Exchange
CAR	Capital-Asset Ratio
CEL	*Compensação Electronica*—cheque clearing system
CPSIPS	Core Principles for Systemically Important Payment Systems
CSD	Central Securities Depository
DEE	*Departamento de Estudos Económicos*—Economic Studies Department, BM
DEM	*Departamento de Mercados*—Markets Department, BM
DFID	Department for International Development
DNS	Deferred net settlement
DVP	Delivery versus payment
ELA	Emergency liquidity assistance
EFTS	Electronic funds transfer system
FDI	Foreign direct investment
FPC	*Facilidade Permanente de Cedência*—BM's standing lending facility
FPD	*Facilidade Permanente de Depósito*—BM's standing deposit facility
FSAP	Financial Sector Assessment Program
FSTAP	Financial Sector Technical Assistance Project
IGS	*Inspecção Geral de Seguros*—Inspector General of Insurance
IFRS	International Financial Reporting Standards
IFS	International Financial Statistics
INSS	*Instituto Nacional de Segurança Social*—National Institute for Social Security
IT	Information Technology
MCI	*Mercado Cambial Interbancário*—interbank foreign exchange market
MFI	Microfinance institution
MMI	*Mercado Monetário Interbancário*—interbank metical market
MoF	Ministry of Finance
NPL	Nonperforming loan
OT	*Obrigação do Tesouro*—long-term Treasury bond
POS	Point of sale
ROAA	Return on average assets
RTGS	Real-time gross settlement
SADC	Southern African Development Community
SIDA	Swedish International Development Agency
SME	Small- and medium-size enterprise
STF	*Sistema de Transferencia de Fundos do Estado*—Govt. fund transfer system
SSA	Sub-Saharan Africa

A joint mission1 from the IMF's Monetary and Capital Markets Department (MCM) and the World Bank Africa Finance and Private Sector Department (AFPD) visited Maputo over the period February 10-23, 2009 to conduct a Financial Sector Assessment (FSAP) update. The previous FSAP was conducted in 2003. The mission evaluated progress since the 2003 FSAP, analyzed financial sector structure, performance, vulnerabilities, and development challenges, and assessed compliance with the Basel Core Principles for Effective Banking Supervision.

This report provides a summary of the main findings and key recommendations.

I. Overall Assessment

1. **Mozambique's overall macroeconomic performance in recent years has been impressive**. Macroeconomic stability, a sustained structural reform effort, substantial foreign aid flows and, until recently, a benign international environment has generated an average annual real GDP growth rate of 7½ percent for most of the past decade. While inflation has been relatively high (around 10 percent annually) and volatile in recent years, reflecting the predominance of food (52 percent) and energy (23 percent) in the consumer basket, underlying inflationary pressures appear to be contained.

2. **In this favorable economic environment, the government has, since 2003 implemented a major financial sector reform program**. The authorities, in collaboration with the World Bank, IMF, and donors, developed and implemented a comprehensive financial sector reform strategy supported by the Financial Sector Technical Assistance Project (FSTAP). Notable financial sector reforms included a new banking law that enhanced supervisory powers (2004); three Commercial Courts in Maputo, Beira, and Nampula (2005); a comprehensive diagnostic review of the major banks (2005); introduction of IFRS (2007); a new bank insolvency law (2007); a new Financial Information Center of Mozambique (GIFiM) law (2007); and a strengthening of supervision, which has been moving toward risk-based assessments. Enhanced transparency and increased use of market instruments improved monetary and exchange rate policy implementation, and real interest rates declined.

3. **As a result, the banking sector's soundness, in particular asset quality, improved substantially.** Between end-2003 and 2008, non-performing loans (NPLs) for the system as a whole declined dramatically (from 14.4 to 2.9 percent), largely reflecting the restructuring of

[1] The mission comprised Dimitri G. Demekas (Assistant Director, IMF—head of mission), Samuel Munzele Maimbo (Senior Financial Sector Specialist, World Bank—deputy head of mission), Erik Feyen (World Bank), Felix Fischer (IMF Resident Representative in Maputo), Silvia Iorgova (IMF), Pamela Madrid (IMF), Ana Rita Mateus (consultant, Bank of Portugal), Ivan Luís de Oliveira Lima (IMF), Rekha Reddy (World Bank), Nicholas Staines (IMF), Jose Tuya (consultant), Rodolfo Francisco Wehrhahn (World Bank) and Alice Zanza (consultant, Bank of Zimbabwe), and was assisted by staff of the IMF and World Bank offices in Maputo and Serap Oguz Gonulal (World Bank) in Washington, DC.

problem banks and assets and a supportive macroeconomic environment. Prudential measures (tightened provisioning requirements on foreign currency credit to non-exporters—Notice no. 05/GBM/2005) led to a sharp decline in foreign currency-denominated loans—and associated risks—from 70.8 percent of total loans to 31.7 percent over the same period. While capital ratios fell somewhat, this appears to reflect higher write-offs of NPLs. The sector remains very liquid, with liquid assets to total assets at 56 percent. In addition to the dramatic de-dollarization of loans as a result of Notice No. 5, the dollarization of deposits also declined modestly from 46.4 percent of total in 2003 to 43.6 percent in 2008.

4. **In contrast, progress in deepening intermediation and improving access to finance was disappointing**. Credit remains costly and constrained: interest margins are among the highest and credit to the private sector as a share of GDP below the average for sub-Saharan Africa. It is also concentrated in relatively few sectors—predominantly large, export-oriented corporates. The provision of financial services remains highly concentrated among a few banks and in urban areas. Only a quarter of all districts have any kind of banking service. Notably, the percentage of the population using formal financial services in Mozambique is among the lowest in the region. Cross-country data collected from the leading banks in 2007 suggest that approximately 10 percent of Mozambican adults have a bank account with a financial institution, the lowest outreach among SADC comparators (Figure 1) and well below the average for the Africa region. Results from a 2007 survey show that the 14 percent of firms with a loan or line of credit in Mozambique is lower than in comparator countries except for Angola and the SSA (sub-Saharan Africa) region (Figure 4). 2008 accounts data from all institutions that report to the BM suggest that less than 5 percent of the adult population has credit from a registered financial institution, and less than 10 percent has a savings account.[2]

5. **In recent months, the global financial crisis has clouded the outlook for the Mozambican economy and financial sector**. The turmoil has not yet affected directly the banking system. The strong capital base, high liquidity, constraints on exposure to foreign currency risk by unhedged borrowers, and capital controls in place mean that immediate contagion risks through financial channels are limited. But Mozambique is likely to be affected by second-round effects through real sector linkages. Although donors are expected to meet their aid commitments in 2009, lower export volumes and private capital inflows will slow economic growth and lead to a deterioration in the external balance, though the latter would be mitigated by lower imports prices and demand. This will have repercussions on the financial system, especially given the relative concentration of bank loan portfolios in the corporate sector and the risk of correlated defaults in a slower growth environment.

[2]This estimate was calculated using 2008 credit account and savings account data from regulated institutions and microfinance operators who report to the BM as a proxy for the number of individuals served, relative to the adult population of Mozambique of approximately 11,067,000 (Instituto Nacional Estadistica 2007). Given that clients tend to have more than one deposit account, the number of deposit accounts was adjusted using BM data on deposit structure for unique clients for a sub-sample of financial institutions for 2007. More detailed data on financial access will be available from the Finscope Financial Access study, which will begin survey work in Mozambique in 2009.

6. **Against this background, this FSA focuses on the key developmental challenges still facing the Mozambican financial sector**. Section II provides an assessment of the structure and performance of the banking sector and the main impediments to financial deepening and outreach. Section III presents the state of development and key challenges in the pension and insurance sectors, respectively. Section IV assesses the payments system infrastructure.

II. Developmental Issues in the Financial System

A. Banking System Soundness and Stability

7. **The Mozambican banking system is very concentrated, well-capitalized and profitable and, due to the low degree of deposit intermediation, highly liquid**. The four largest commercial banks—all of which are majority foreign-owned—account for almost 90 percent of total system assets. At 3½ percent, the return on assets is high, well above Mozambique's peer group and the regional average. Average regulatory capital stands at 14½ percent of risk-weighted assets, well above the 8 percent minimum capital adequacy requirement, and reported NPLs have been steadily declining and stood at 2.1 percent of total loans at end-2008. After increasing in 2005-06, the loan-to-deposit ratio has remained at 50-55 percent, with most banks relying entirely on domestic deposits to fund lending and excess funds placed in liquid instruments domestically or abroad.

8. **The current levels of soundness and stability are a significant improvement from the 2003 FSAP**, which found that high credit risks and underprovisioning undermined the soundness of the banking system. Banks were vulnerable to credit risk, mostly due to their highly concentrated loan portfolios. This vulnerability was further elevated by macro-monetary volatility and a poor lending environment. The system's exposure to other risks (currency, interest rate, and liquidity) was found to be moderate, with the caveat that lack of information on off-balance sheet positions limited the analysis of direct foreign exchange risk, while lack of information on loans to non-exporters limited the assessment of indirect foreign exchange risk (such as foreign currency-induced credit risk). The FSAP recommended a comprehensive audit review to assess the situation of the banking system and the impact of implementing international accounting standards.

9. **Since then, banks' asset quality and profitability have improved substantially, although NPL classification remains an area of concern.** Reported NPLs fell from 14.4 percent of assets in 2003 to 3.8 percent in 2005, largely reflecting restructuring of problem banks and assets. The clean-up of balance sheets in 2005 has resulted in a large jump in profitability ratios, as bad assets were written off loan loss reserves. Since then, year-end NPLs have also remained below 3 percent, although with considerable dispersion (a few small and medium-sized banks have NPL ratios twice that of large banks), as well as intra-year variability. The BM's NPL definition, however, mostly includes only the past-due installments, not the entire loan, and specific provisions have declined from an average of 103 percent of total NPLs in 2007 to 68 percent in September 2008 (with a few small and

medium-size banks significantly underprovisioned). At the same time, the dollarization of loans and indirect foreign currency risk have declined—largely reflecting the introduction of Notice No. 05/GBM/2005, that requires an initial 50 percent provisioning of loans to non-exporters—while direct foreign currency risk exposure remains limited.[3]

10. **The system remains highly capitalized and liquid, and most banks are not exposed to much funding risk**. Despite fast credit growth in recent years, the sector remains highly liquid in both domestic and foreign currency, with Metical liquid assets[4] covering 79 percent of short-term domestic currency liabilities and foreign assets (mostly deposits at correspondent banks) covering 69 percent of deposits in foreign currency. Banks rely principally on stable, retail deposits for funding, with a very limited role for borrowed foreign funds (amounting to less than 1 percent of total assets as of September 2008, much lower than in other countries in the region). Domestic interbank market funding is also very limited. Average regulatory capital stood at around 14 percent of risk-weighted assets, well above the 8 percent minimum capital adequacy requirement.

11. **However, concentration risk remains considerable, as the number of creditworthy customers is limited in Mozambique**. Concentration risks have declined since the 2003 FSAP, when most banks' largest 3 borrowers constituted more than 50 percent of total loans. However, they remain elevated: at some medium- and small-sized banks, the 20 largest borrowers account for as much as 85 percent of all loans at end-2008. While larger banks tend to have more diversified loan books (with the 20 largest borrowers accounted for roughly 40 percent of all loans, partly reflecting their expansion into retail lending), larger foreign-owned banks have substantial foreign assets concentrated in parent or correspondent banks. Furthermore, banks' lending is also highly concentrated in a few sectors, such as energy and commodities, with concentration higher at smaller banks.

12. **While Mozambique has not been directly impacted by the global financial crisis, second-round effects that may reduce exports and growth have increased credit and liquidity risk**. The global turmoil could affect financial systems in emerging economies like Mozambique through two main channels: direct financial linkages (for example, reflecting losses on asset-backed securities in bank portfolios, a sudden stop in wholesale funding flows to banks, contagion through parent banks, etc.), which essentially give rise to market and liquidity risk; or real sector linkages (for instance, the impact of a slowdown in global demand for exports or a drop in aid and/or FDI flows) that create credit risk. With the exception of possible contagion from problems at parent banks or correspondent banks (usually part of the same financial group)—which cannot be ruled out but appear unlikely given their current strength and capital controls—Mozambique is not exposed to significant

[3] Most banks' balance sheets are net long foreign currency. However limited information on banks' off-balance sheet exposures hampers the analysis of their overall net open position.

[4] Including: cash, deposits with the BM, short-term interbank loans, and Treasury bill holdings.

risk from direct financial linkages, as market and liquidity risk exposures are limited. It is, however, exposed to significant risk from real sector linkages. Growth and external balance projections for 2009–10 are now subject to substantial uncertainty, which contribute to heightened credit risk for banks.

B. Banking Regulation and Supervision

13. **There has been significant improvement in compliance with the Basel Core Principles for Banking Supervision (BCP) since the 2003 FSAP. Significant progress has been made in implementing the 2003 FSAP recommendations.** The most significant area of improvement has been the development of regulation and supervisory guidelines. BM started to move away from a regulatory compliance focus to a more risk-based supervision. Overall, an adequate regulatory framework for bank supervision has been adopted. Today, Mozambique is compliant or largely compliant with 17 Basle Core Principles for Effective Banking Supervision, 8 more than in 2003, and materially non-compliant or non-compliant with 8 principles, half as many as in 2003.

14. **BM seems to have a good overview of the Mozambican banking sector as a whole and of individual institutions**. Regular reports and analysis of the financial situation help provide an up-to-date view of each institution, and more detailed insights are acquired through yearly on-site inspections. This framework allows BM to detect areas or flaws to be addressed, and it is common procedure, mainly after on-site inspections, for the BSD to recommend necessary actions.

15. **Despite this progress, important shortcomings remain, especially in the areas of loan classification and provisioning, assessment of risks other than credit, such as liquidity or country risk, and remedial action.**

16. **The current loan classification and provisioning regulation does not provide an early warning** as to deteriorating trends since the time-based classification and provisioning buckets are so wide. The regulation needs to be amended and establishment of loan loss provisions be made more risk-sensitive.

- *Loan classification and provisioning*. The current loan classification and provisioning regulation does not provide an early warning as to deteriorating trends, since the time-based classification and provisioning buckets are so wide. In addition, the amount of delinquent loans is understated, since only the payment is shown as delinquent and not the full loan principal. The regulation needs to be amended and monitoring of loan loss provisions made more risk-sensitive. For example, in its inspections and monitoring, the BM should ask for more provisions, not only because the bank file did not contain all required documents, but also because the borrower’s financial condition may be deteriorating.

- *Risk monitoring and management.* BM practices in supervising interest rate, country, liquidity, and market risk, and AML are rated non-compliant or materially non-compliant. Some of these areas are not regulated at all, while in other areas, the regulations do not always have attendant guidance to aid BM staff in monitoring compliance or to provide banks with the minimum requirements they are expected to meet when developing risk management systems or internal policies and procedures.
- *Prompt remedial action*. BM powers are not used effectively to induce remedial and corrective actions when it is necessary. It is widely known that there is a small bank that has been in financial distress for a long time, as well as other small credit institutions whose credit portfolio is of poor quality. Even though these institutions are not systemically important, the BM's inability or unwillingness to act decisively raises questions about its credibility in the supervision of the banking system. It appears that, while the BM ensures that minor remedial actions are addressed by management, it is very slow to act when important problems occur at a bank, such as insufficient capital and/or inadequate provisioning of assets. An effective remedial action program can instill discipline, make remedial steps more systematic, identify and penalize poor management, and remove ineffective or unsound managers from the system.
- *Foreign supervisory coordination:* As several large banks in Mozambique are foreign-owned, the BSD needs to be familiar with the home country supervisor, the strength of support that may be available from the parent company, the home country rules in a bankruptcy situation, and economic conditions in the home country. With the global implementation of Basel II and the plans to implement it also in Mozambique, the BM will need to coordinate with the home supervisor to ensure it is familiar with capital allocations to the Mozambique operations, particularly in the area of operational risk. Monitoring the risk in the concentration of deposits in parent banks is another area that requires the BSD to collaborate with the home supervisors and be familiar with country risk.
- *Prudential regulations:* The BM is in the midst of developing a significant amount of guidance to continue enhancing its supervisory process. The BM is developing procedures for monitoring compliance with AML requirements and guidelines on internal audit, it has drafted—but is holding in abeyance—guidelines for banks on integrated risk management, and it is also drafting the supervision by risk guidelines. These efforts need to be brought to fruition as soon as possible.

17. **In tackling these challenges, the BM should make greater use of best practice guidelines**. The BM has issued a number of regulations that include requirements, such as, for internal controls and credit risk management. The BM is also developing guidelines setting best practices in these areas. Outlining best practices, in addition to minimum requirements, can be an important regulatory tool.

18. **Concentration of banks' correspondent accounts abroad needs to be monitored closely**. Some of the foreign-owned banks have significant concentrations in parent bank deposits. The current global financial environment warrants closer monitoring by BSD of the risks posed by those deposits, including assessing country risk and holding structured and regular discussions with the home supervisors. This will allow BSD to determine when risk makes those concentrations unwarranted and whether it should mandate their diversification.

19. **The BM should develop a remedial action program for the application of sanctions and remedial actions**. This program should include guidelines that: provide for a graduated application of remedial actions; define the circumstances under which they are applied; provide timeframes for correction; and establish an internal process at the BM to ensure that recommendations for enforcement action are decided in a timely manner. Exerting its powers for remedial actions whenever justified would increase transparency and confidence in the system. Box 5 provides additional detail on such a remedial action program.

20. **The BM should ensure that adequate resources are dedicated to the completion of the supervisory guidance now under development**. More generally, it should continue to strive for up-to-date training and adequate human resources in the BSD, and ensure that supervisory capacity is adequate to supervise the expansion of credit institutions to remote geographical areas.

C. Access to Finance

21. **Since 2003, aggregate credit and, more broadly, the outreach of Mozambican lending institutions have increased.** Private sector credit to GDP increased from 8.6 percent in 2003 to 12.8 percent in 2007. The number of credit and deposit accounts in the system increased by 48 percent and 233 percent respectively between 2004 and 2008. Physical infrastructure, in the form of bank branches, ATMs and POS (point of sale) devices has increased significantly.

22. **However, by some measures, the percentage of the population using formal financial services in Mozambique is among the lowest in the region.** Savings account data collected from banks in a number of countries in 2007 suggest that approximately 10 percent of Mozambican adults have an account with a financial institution, the lowest outreach among SADC comparators (Figure 1) and well below the average for the Africa region. Results from a 2007 survey suggest that the 14 percent of firms with a loan or line of credit in Mozambique is lower than in all other comparator countries and the SSA (sub-Saharan Africa) region except for Angola (Figure 2).

Figure 1: No. of Accounts per 1000 adults

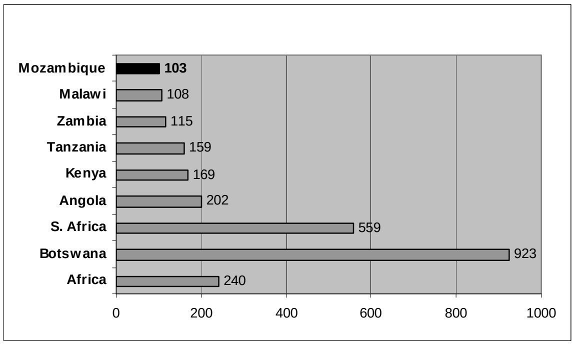
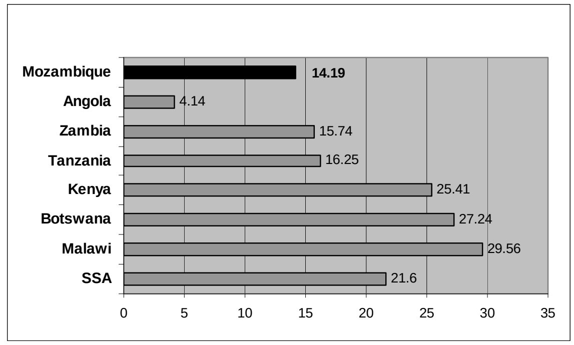


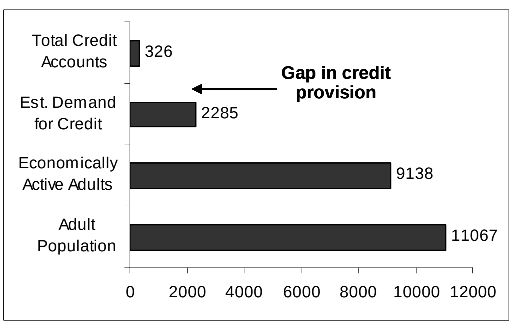
Figure 2: Firms with Credit



Source: FSAP Analysis of *Banking the Poor* data, 2009 (Figure 1) and World Bank Investment Climate Data (2005 to 2008) (Figure 2)

23. **Approximately 90 percent of Mozambican adults are not served by formal financial institutions, with access to credit particularly constrained.** Accounts data from 2008 provided by the *Banco de Moçambique* (BM) suggest that 3 percent of the adult population has credit and that approximately 8 percent of the adult population has a deposit at a formal financial institution, depending on the assumptions made.[5] Assuming that just 25 percent of the economically active population might be potential candidates for credit, an estimated 15 percent of market demand for credit is currently being served (see Figure 3).

Figure 3: Gap in Credit Provision



(Reported in '000)

Table 1: Branch and ATM Penetration

Branch and ATM Penetration: Comparison Across Countries				
	Branches per 1000 km2	Branches per 100,000 people	ATMs per 1000 km2	ATMs per 100,000 people
Mozambique	**0.38**	**1.43**	**0.57**	**1.7**
Botswana	0.11	3.77	0.27	9.0
Kenya	0.77	0.37	0.56	0.59
South Africa	2.22	5.99	6.49	17.5
Tanzania	0.23	0.57	0.07	0.17
Zambia	0.21	0.21	0.09	0.65
Zimbabwe	1.11	3.27	1.15	3.38

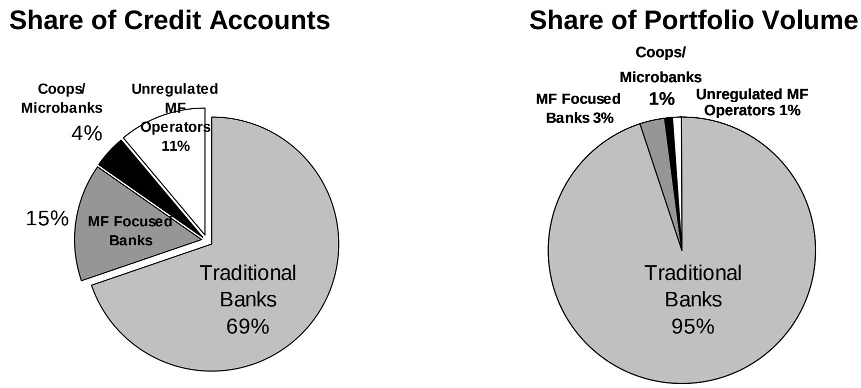
Source: FSAP Analysis of BM Data 2008 & Beck et. al (2005)

[5]This estimate was calculated using December 2008 accounts data from regulated institutions and microfinance operators who report to the BM as a proxy for number of individuals served, relative to the adult population of Mozambique of approximately 11,067,000 (Instituto Nacional Estadistica 2007). A total of 324,762 credit accounts and 1,358,736 savings accounts were reported. However, assuming that approximately 40 percent of deposit account holders have more than one account (as suggested by 2007 BM data for a sample of institutions showing unique account holders and in interviews with staff of banks), the number of deposit account holders is estimated to be 815,242. The data presented in Figure 1 that enables international comparisons does not assume that individuals hold more than one account, hence the higher percentage of population deemed to have a bank account. More detailed data on usage of financial services should be available from the Finscope Financial Access study, which plans to begin survey work in Mozambique in 2009.

24. **In terms of physical infrastructure, Mozambique's branch and ATM penetration ranks among the middle of its peers.** In 2008, Mozambique's branch and ATM penetration was generally lower than in more developed countries such as Botswana, South Africa and Zimbabwe in 2005 (see Table 1), but higher than in Zambia and Tanzania. Mozambique's strong performance relative to Tanzania, Zimbabwe and in some cases, the wealthier Kenya, may be due to the difference in the years of data presented, as ATM penetration has expanded dramatically throughout Africa in the last five years. In 2008, there was approximately 1 branch for every 69,767 Mozambicans, a significant improvement from 2006 when there was 1 branch for every 89,328 Mozambicans.[6]

25. **Traditional banks are the dominant financial service provider, but their outreach remains low.** Traditional banks continue to service 95 percent of credit volume and 69 percent of credit accounts. The market share of banks is even higher for deposit accounts, with 98 percent of deposit volume and 86 percent of deposit accounts. The large banks (BIM, BCI and Standard Bank) hold 63 percent of credit accounts, and 53 percent of deposit accounts, with BIM by far the largest holder of both types of accounts.

Figure 4: Financial Institutions Providing Credit



Source: 2008 Bank of Mozambique Data, FSAP Analysis

26. **Although microfinance has grown steadily since 2003, overall outreach remains limited.** The 2003 FSAP estimated that microfinance institutions served approximately 50,000 clients. At the end of 2008, that number had increased five-fold (see Table 2). Of the different categories of microfinance institution, the microfinance-focused banks have the largest outreach, as they provide 50 percent of credit accounts and 93 percent of deposit accounts.

[6] Patel, Yasmin et al. *Bancarizacao da Economia: Extensao dos Servicos Financeiros as Zonas Rurais.* Banco de Mocambique. 2007.

Table 2: Mozambique Access to Financial Services. Overview as of December 31, 2008

	# of Accounts	Share of Total # of Accounts	Amount (MZN '000)	Share of Volume (%)	Average Size (US$)
CREDITS	**324,508**		**44,020,807**		
Traditional Banks	224,739	69%	42,076,883	96%	7,489
Microfinance Focused Banks	49,956	15%	1,290,592	3%	1,033
Microbanks and Cooperatives	13,389	4%	465,238	1%	1,390
Unregulated MFIs	36,424	11%	188,238	0%	207
DEPOSITS	**1,358,736**		**77,664,805**		
Traditional Banks	1,144,104	84%	76,106,728	98%	2,661
Microfinance Focused Banks	199,467	15%	1,176,185	2%	236
Microbanks & Cooperatives	15,091	1%	381,892	0%	1,012
Unregulated MFIs	-	-	-	-	-

Source: FSAP Analysis of 2008 BM Data. Data for unregulated MFIs is from June 2008, all other data is from December 2008. Data from all registered financial institutions are included with the exception of 1 bank, 2 cooperatives and approximately 47 unregulated MFIs.

27. **Banks are increasing their intermediation, but are focused on large clients.** The loan-to-deposit ratio for traditional banks was slightly greater than 50 percent in 2008, while the ratio for microfinance-focused banks was over 100 percent. One large bank had a loan-to-deposit ratio of just 30 percent. Banks continue to have difficulty with smaller transactions, as they are seen as high cost transactions with very low margins. When interviewed, however, some discussed their interest in expanding outreach to maintain share as competition increases.

28. **Financial intermediation is also highly segmented: large corporates and salaried employees have relatively good access to credit...** According to the World Bank's recent Investment Climate Assessment, 61 percent of large corporates in Mozambique have access to a line of credit or loan with a financial institution. This share is much higher than that of small and medium enterprises, which access credit at rates of 7 and 16 percent, respectively, and largely finance their businesses out of retained earnings. Loans to salaried workers are a growing segment, with a number of commercial banks providing credit to thousands of employees whose salaries are disbursed through corporate payroll accounts at these banks.

29. **...While for many segments of the population, access to credit and financial services is severely constrained**. The recent Investment Climate Assessment found that the percentage of firms accessing lines of credit is not only low at 13 percent, but also has declined from previous surveys in 1997 (35 percent), 2002 (29 percent), and in 2006 (26

percent)—especially for SMEs[7]. Rural populations also remain underserved in terms of financial services: in 2008, branches in rural and peri-urban areas held roughly 20 percent of the number of credit and savings accounts as urban branches, even though these areas account for over 60 percent of the country's inhabitants.

30. **What explains the slow progress in financial deepening and financial sector outreach in Mozambique?** The factors at work fall into two broad categories: (i) economy-wide, structural impediments to financial intermediation, which limit the number of credit-worthy clients or increase the costs and risks of extending credit or offering financial services; and (ii) specific characteristics of the Mozambican banking system that hamper competition, reduce incentives to mobilize deposits, and contribute to high borrowing costs.

(i) Economy-wide impediments to financial intermediation

- *Poor physical access and infrastructure.* Unstable electricity supply, poor road conditions, amongst other infrastructure concerns deter rural branch expansion, along with difficulty finding skilled human resources.
- *Obstacles to the use of technology in advancing access to finance*. In 2004, Law 15/99 created a new provider called an "electronic money institution" for institutions seeking to do mobile banking. Telecoms and banks are waiting for clarity from the BM regarding several issues, including: the nature of "know your customer requirements" for these transactions; the ability to outsource payments functions to agents; the potential to mobilize deposits under the "deposit broker" category in Decree 57/2004; and whether mobile banking must be bank-based or could be managed by a telecom operator independent of a bank.
- *Weaknesses in the legal and regulatory framework*. The inability of creditors to pursue court cases against debtors is a major deterrent to credit. World Bank Doing Business indicators suggest that enforcing a contract in Mozambique continues to be one of the costliest in the region, and that enforcement takes substantially longer than the regional average—despite recent improvement (from 1010 to 730 days). A draft

[7] There are several possible explanations for the reduction as something more than an artifact of different representative samples. First, this survey may denote a better, albeit lower, credit quality portfolio, because the privatizations in the financial and industrial sectors may have resulted in more selective lending. Thus, while the volume of loans may have increased, it was to a smaller number of better-managed, privately-owned firms. Second, the reduction could point to the recent regulation Aviso 5/2005 which requires banks to set aside a 50 percent loan-loss provision against bad debts for loans denominated in foreign currency that are issued to nonexporters. The regulation resulted in a decrease of aggregate lending in foreign currency from 60 percent in early 2005 to 36 percent in late 2006. Several firms now have to borrow in meticais at a higher interest rate (around 25 percent) rather than at an interest rate of about 10 percent. According to USAID (2007), this interest rate gap was greater than exchange rate risk alone would suggest, and Aviso 5/2005 might have reduced credit demand for certain types of firms. Third, but likely to a lesser degree, the improving regulatory, accounting, and provisioning regulations, and the entry of international banks into the sector with home country regulators requiring higher standards of credit assessment may have contributed to a reduction in firms with access to easy credit. Finally, there is evidence that overdraft use across firms increased compared to the Enterprise Survey results of 2003; this may suggest that there has been some degree of substitution in how firms finance their operations.

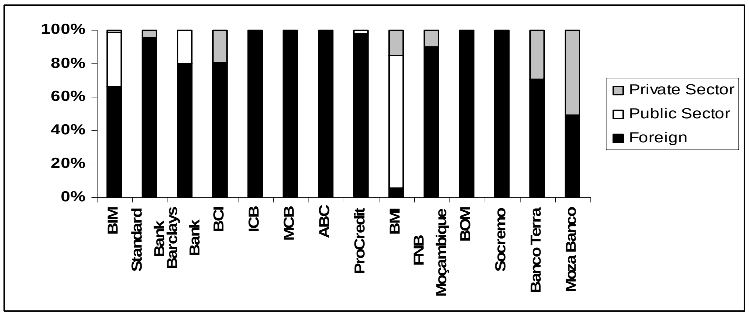
bankruptcy law was submitted to Parliament but is yet to be enacted. In addition, the arbitration center in Maputo, reputed to be efficient, processes fewer than 25 cases per year. Fees required to pursue a case are also high.

- *Weak financial reporting*. Credit officers encounter difficulties in obtaining basic cash flow information from SME customers in contrast to their corporate clients. Information provided by smaller firms is often not supported by tax sources and often found contradictory during the credit evaluation process. All private sector entities in Mozambique, including those with foreign participation, are affected by a serious shortage of qualified accountants.
- *Problems with the credit and property information infrastructure*. The scope of information collected in the *credit registry* is limited. The registry, currently operated by the BM, collects both negative and positive credit behavior information for individuals and firms from the 21 regulated financial institutions. Although coverage has improved, the registry data cover just 2 percent of the adult population, and there is a 3-week lag in data availability. The registry does not include or link to data from other systems containing client information, such as utility companies, tax, or commercial registries, nor does it include information from unregulated microfinance institutions. A private registry, currently under consideration, may facilitate the collection of such information; however, it is unclear whether the legal framework allows the operation of private credit registries. The *property registry* is also limited and antiquated: it is estimated that less than 30 percent of property is registered. The registry is still paper-based and not interlinked between major cities, which drives up costs and facilitates fraud. The cost of registering property is high.

(ii) Structural characteristics of the banking system

31. **Mozambique's banking system is concentrated and mostly foreign-owned.** Currently, 14 banks are operating in Mozambique. Three banks cater to the microfinance market, while the other banks serve the mainstream corporate and retail sectors. No major changes in market players have occurred during the last five years, with the exception of the entry of two banks in 2008, Banco Terra and Moza Banco. All banks are foreign owned, with the exception of Moza Banco, which has domestic private majority shareholding, and BMI, which is currently under government control (Figure 5). The system is very concentrated, with the largest bank (BIM) and the three largest banks combined (BIM, BCI, and Standard Bank) accounting for 40 percent and 85 percent of assets, respectively.

Figure 5. Mozambique: Ownership Breakdown by Type (in percent)



32. **In addition to the economy-wide structural impediments to financial intermediation, certain characteristics of the Mozambican banking system hold back progress,** hamper competition, reduce incentives to mobilize deposits, and contribute to high borrowing costs.

33. **Analysis suggests a lack of competition in the banking system.** High industry concentration (Figure 6) and a formal Rosse-Panzar competition test point to limited competitiveness.[8] In addition, BM research[9] shows that lending rates of bigger banks tend to be responsive only to a market leader. While not providing conclusive proof, these findings suggest strongly that competitive forces in the Mozambican banking system are weak, even though there are indications that the situation is gradually improving.

34. **The lack of competition is further supported by the following inter-related findings.**

- ***High interest rates and spreads***. The net-interest margin, based on international Bankscope data, is much higher than in comparable countries or in the region (Figure 7). A similar measure based on BM data, the ex-post interest margin, has grown from 9.1 to 13.9 percent in 2004–07. And in spite of a decline, the interest spread recently stood as high as 7.5–10 percent.
- ***High profitability.*** Bank profitability in Mozambique is among the highest in the world, and has been steadily increasing—albeit from a low level—since 2004 (Figure 8). For example, in 2007, the return on average assets (ROAA) was 3.5 percent, which is much higher than Mozambique's peers and the regional average. Similarly, the return on average capital (ROAC) is high and grew strongly. The ROAA and ROAC jumped significantly in 2005 after the restructuring of problem banks and write-offs.
- ***High overhead costs***. A breakdown of the interest margin reveals that its high level is mainly explained by high overhead costs. The spread can be broken down into five components: provisions, reserve requirements, overhead costs, profit, and tax (Figure 9). As in other African countries, overhead costs account for over half of the spread. Overhead costs in Mozambique, however, are higher compared to other countries with similar banking systems (Figure 10). High overhead costs could be explained by a number of different factors: high input costs, for example, due to inflexible labor laws, absence of economies of scale, or lack of competitive pressures.

[8] The Rosse-Panzar methodology essentially measures the pricing power of firms in a sector. It uses the so-called H-statistic, which measures the extent to which an increase in factor input prices translates into a change in total revenues. When there is perfect competition (H=1), an increase in input prices—such as staff, interest, and other costs—increases marginal costs and revenues by the same amount. In the case of a perfect monopoly, an increase in input prices increases marginal costs, but reduces output and thus reduces total revenues (H<0). In most cases, the H-statistic ranges between 0 and 1. Mozambique's H-statistic is around 0.3. Zambia's H is around 0.5. For details on this methodology, see Panzar, John, and James Rosse (1987), "Testing for 'Monopoly' Equilibrium." Journal of Industrial Economics Vol. 35, pp. 443–456.

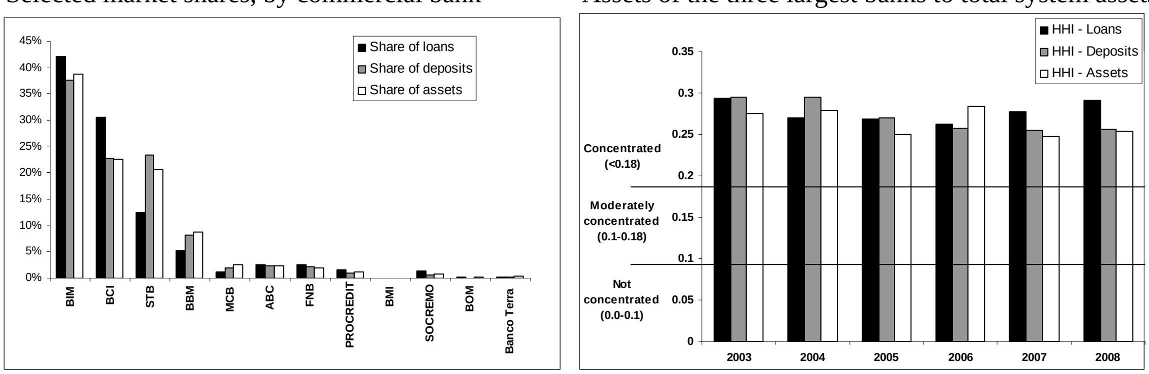
[9] Bank of Mozambique Research Department (2007), "Costs of Financial Intermediation versus Profitability of the Credit Institutions".

The combination of high overhead costs and high profits in the case of Mozambique suggests that the latter is a likely explanation.

- ***High bank commissions and fees***. Bank commissions are relatively high and show strong dispersion among banks, and may act as an impediment to access to finance. Previous studies[10] found that bank commissions are pervasive, not transparent, and high compared to peer countries (Figure 10); and that some commissions, such as the annual debit card fee or fee for issuing an emergency check, have more than doubled since 2003, despite the increase in the number of bank accounts, ATMs, and POS.[11] Bank commissions are also highly dispersed (Figure 10). The high costs imposed for account maintenance and the mandatory bundling of services by banks inhibit savings mobilization. Since savings serve as an entry point to credit access, as certain financial institutions require a savings history with the institution as a condition for providing credit, high fees also have a detrimental effect on credit expansion.

Figure 6. Mozambique: Banking System Concentration and Ownership, 2008

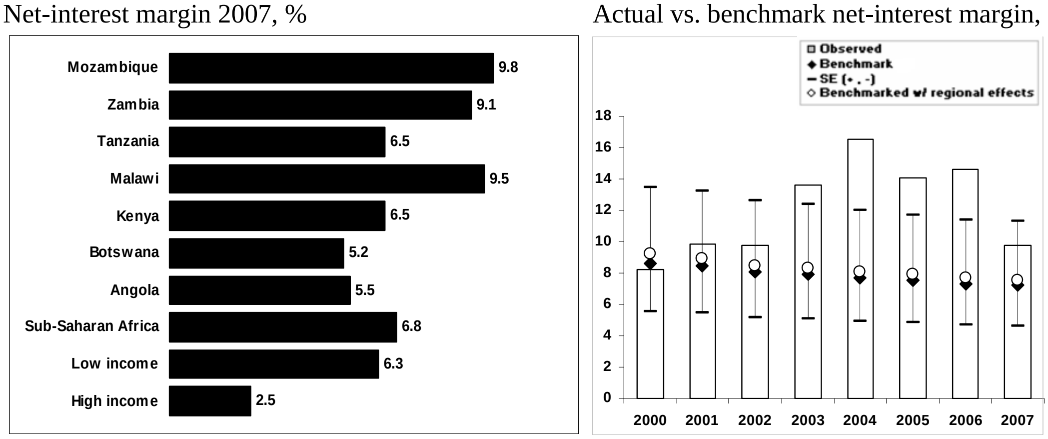
Selected market shares, by commercial bank | Assets of the three largest banks to total system assets



Source: Bank of Mozambique and FSAP Analysis./ Note: Threshold values for “Moderately concentrated” and “Concentrated” are taken from the United States Department of
Justice Antitrust Division guidelines.

Figure 7. Mozambique: Banking Sector Efficiency Benchmarks for Mozambique, 2000–07

Net-interest margin 2007, % | Actual vs. benchmark net-interest margin, %



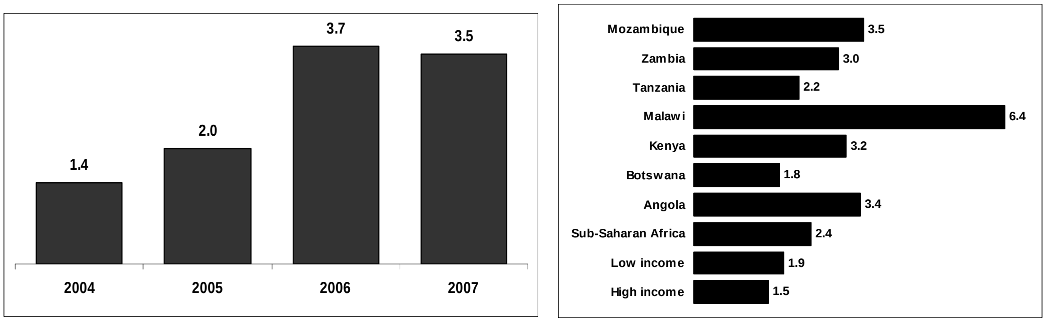
Source: Bankscope and FSAP Analysis.
Note: The statistical benchmark model is described in Beck, Feyen, Ize, and Moiszeswicz (2008).

[10] USAID (2007), “Financial Sector Constraints on Private Sector Development in Mozambique.”

[11] Bank of Mozambique Research Department (2007).

Figure 8. Mozambique: Banking Sector Profitability, 2004–07

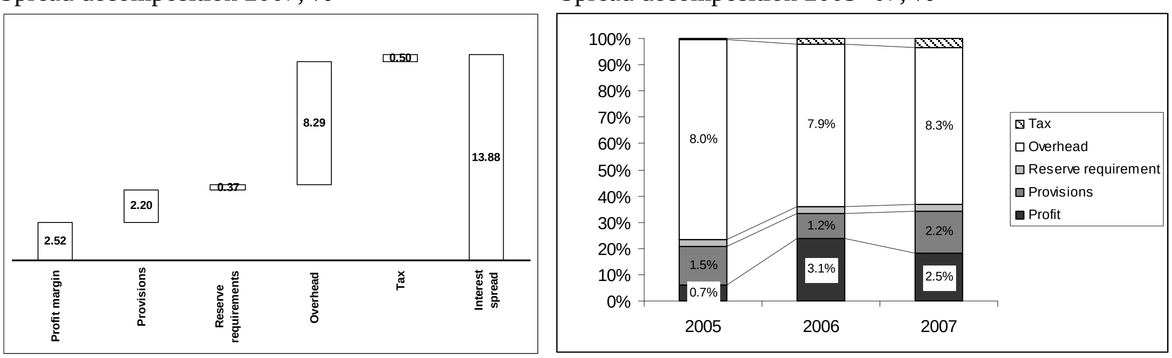
Return on average assets (ROAA) in Mozambique, % ROAA for selected countries in 2007, %



Source: Bankscope, Bank of Mozambique and FSAP Analysis.

Figure 9. Mozambique: Total Ex-Post Interest Spread Decomposition, 2005–07

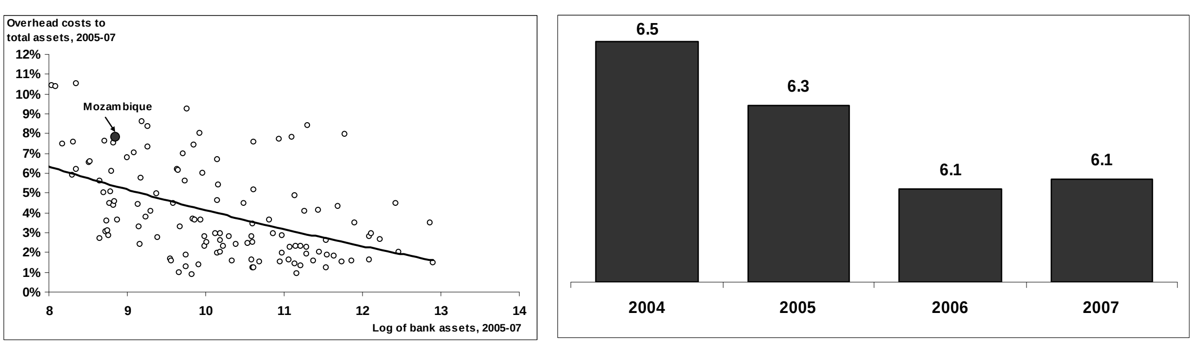
Spread decomposition 2007, % Spread decomposition 2005–07, %



Source: Bank of Mozambique and FSAP Analysis.
Notes: Provisions is provisions divided by total net loans. The reserve requirements component is calculated as the average ex-post deposit rate divided by (1-LRR)/LRR. Overhead costs are proportionately allocated to the fraction of loan interest income to total income and divided by average net loans. Tax and profit margin are calculated based on the residual. Tax is based on the actual tax paid.

Figure 10. Mozambique: Banking Sector Overhead Costs, 2004–07

Overhead costs vs. bank system size (IFS), 2005–07 Mozambique overhead costs to assets (BM), 2004–07



Source: International Financial Statistics, Bankscope, Bank of Mozambique and FSAP Analysis.

(iii) Structural characteristics of the microfinance sector

35. **Microfinance-focused banks perform relatively well compared to benchmarks.** The Mozambican microfinance-focused banks appear solid relative to MIX/CGAP benchmarks for African microfinance institutions. The portfolio at risk from 2008 is similar to the benchmark for microfinance institutions with a bank charter, and return on assets is higher than the benchmark (see Table 3). However, their productivity per employee is almost half that of the institutional benchmark, suggesting that low productivity may be contributing to low outreach. Indeed, all of the interviewed microfinance banks stated that finding and retaining quality human resources were serious challenges.

36. **Some cooperatives have high delinquency and low profitability.** Unlike Microfinance-focused banks, Mozambican cooperatives have productivity ratios that compare favorably with the benchmark for African cooperatives (see Table 3). However, it may be that the lean staffing for these institutions may contribute to some weaknesses in portfolio quality. In evaluating the PAR (portfolio at risk) for 6 cooperatives relative to benchmarks, the following results were revealed: 2 were close to the benchmark, 2 were extremely high, and another 2 institutions did not report required data. Their supervision reports from the BM suggest operational weaknesses and significant NPLs. Although the 4 institutions reporting financial statements to the BM had an average RoA of -6 percent (the same as in 2004), two cooperatives with particularly low RoA pulled down the average. The one microbank, although not analyzed in the table above, also has a very high level of NPLs and is not reporting to BM as required.

37. **Unregulated microfinance operators are fragmented, and some show institutional weaknesses.** As a group, the 77 unregulated microfinance operators that are registered with the central bank are characterized by a high rate of entry and exit. Minimum capital requirements are very low, and many are heavily subsidized by government and donor funds. Many of these institutions are small, serving an average of 800 clients each, and some have limited staffing structures. Even with subsidies, these institutions charge interest rates ranging from 5 to 9 percent per month. The 26 institutions who chose to report data as required by the BM in June 2008 had a PAR>30 days of approximately 9.4 percent, which is higher than the Africa benchmark level.

Table 3: Performance of Microfinance Institutions Relative to Benchmarks

	MICROFINANCE-FOCUSED BANKS		COOPERATIVES	
	Mozambique	**Benchmark**	**Mozambique**	**Benchmark**
Age[1]	7	7	9	12
Total Assets	$25,089,280	$34,746,317	$16,075,284	$4,602,738
# Branches	16	12	3	21
No. of employees	380	244	47	100
OUTREACH				
Number of Borrowers	17,301	19,603	3,926	8,109
Outstanding Loan Portfolio	$17,173,071	$12,028,393	$4,631,638	$2,871,654
Average Loan Balance	993$	$708	$1,180	$494
Avg. Loan Balance/GNP per capita	261%	126%	310%	112%
Number of Depositors	66,998	51,147	3,648	21,832
Deposits	$15,682,460	$15,797,481	$3,668,033	$2,465,858
Average Deposit	$235	$187	$1,005	$166
PROFITABILITY, DELINQUENCY AND PRODUCTIVITY				
ROA [3]	1.8%	0%	-6%	-1%
PAR>30 days [4]	3.7%	3.5%	16.9%	6.7%
Personnel Productivity [5]	46	83	84	69

[1]FSAP Analysis of 2008 data from Mozambique's 3 microfinance-focused banks (Banco Oportunidade, Procredito and Socremo) and 4 cooperatives (UGC, CPC, Tchuma and CCC)
[2]Benchmark data are from the MIX/CGAP Africa Microfinance Analysis and Benchmarking Report December 2008, utilizing 2007 data from 14 African MFIs with bank charters and 35 cooperative MFIs
[3]ROA = (Net operating income-taxes)/Average total assets
[4]PAR (Portfolio at Risk) > 30 days = Outstanding balance of loans overdue > 30 days/Loan portfolio
[5]Personnel productivity = Borrowers per staff member=Active borrowers/Number of Personnel

38. **Limited resources exist to provide capacity building, supervision and monitoring to microfinance institutions.** AMOMIF (the Association of Mozambican Microfinance Operators) was formally created in August 2007, but at the time of the FSAP did not have a single full-time member, leaving a gap in capacity building and coordinating activities that were planned through this institution. At the same time, supervision and monitoring a sharply increasing number of microfinance institutions has been time-consuming for the BM. Following up on regulated institutions that are not reporting as required has been a challenge. Perhaps in the future, an independent entity could assist BM with information gathering for unregulated institutions.

39. **Microfinance offers a key point of entry to the unbanked, but should be monitored carefully.** Non-repayment of credit by the client and poor management of deposits by the institution are a key risk. Spelling out technological, audit, cash management and reporting requirements clearly, perhaps in the form of a licensing manual, would provide potential entrants into the market with clear guidelines and ensure that new institutions have the capacity to serve customers safely.

40. **Credit and deposit size for microfinance institutions suggest a varied client base.** Both cooperatives and microfinance-focused banks have average loan sizes that are slightly over $1000 (see Table 2), approximately 3 times per capita GDP. The ratio of loan size to GDP is higher than the benchmark for African institutions with similar charter types (see Table 3). Both of these figures suggest that they are not serving the smallest of microbusinesses.[12] However, the loan-size-to-GDP ratio for unregulated microfinance operators is far lower, suggesting that these institutions are open to a broader segment of the unbanked population.

(iv) Policies to encourage financial intermediation and competition

41. **Addressing these weaknesses requires action across several fronts**, which in many areas is already under way.

- On the *legal and regulatory front*, efforts should continue to encourage alternative dispute-resolution mechanisms and out-of-court settlements, the expansion of arbitration services, the establishment of a small claims court and, more generally, the strengthening and modernization of the judiciary, including a review of the court fee structure. The BM should clarify its policy and requirements on mobile banking operators, the permissibility of outsourcing of services to agents, and the possibility of collecting deposits under the "deposit broker" category.
- To strengthen *institutional infrastructure and information*, the scope of the credit bureau should be expanded to cover a greater range of information and potential borrowers, and the plans to modernize the property registries should be implemented.
- To improve *financial reporting*, new Financing Reporting legislation covering all regulatory aspects of accounting and auditing should be enacted, and the Commercial Code accordingly amended. Until the number of qualified accountants has reached a satisfactory level, restrictions on foreign workers in this area should be relaxed.
- Since there are no barriers to entry, and the banking market is, in principle, contestable, there are few measures the BM can take directly to promote *competition in the banking system*. Enforcing greater transparency and requiring dissemination of the various fees imposed by banks will stimulate competition.

42. **All these measures, however, will yield results only gradually**. Many of the impediments to credit expansion and financial intermediation, such as poor infrastructure and human capital, reflect developing country realities and can only be overcome in the long run. Others, like weaknesses in the property registries, accounting standards[13], or the judicial system, are being addressed by policymakers, but these efforts require time to generate

[12] One study states that the loans that are made in amounts less than one-fifth of per capita GDP suggest that unregulated MFIs are lending to the poor. Barres, Isabelle. "Bulletin Highlights" The MicroBanking Bulletin: Microfinance Information Exchange, Issue No. 8. November 2002.

[13] New regulations for commercial banks on the assessment, classification and provisioning of credits as well as a regulation on integral risk management for credit institutions and finance companies in line with IFRS were approved in May 2007. The BoM is working with the commercial banks to facilitate implementation in 2008/09 and has established a special task force to assist banks that have difficulties in interpreting the IFRS.

tangible improvements. In addition, the lack of competition in the domestic banking system is to a large extent the result of the small size of the market. As the market grows, competitive pressures will intensify; but in the short run, the best policy for the BM is to maintain macroeconomic stability, continue the strong supervision of the banking system, and ensure transparency and a level-playing field.

D. Pensions

43. **The pension sector remains dominated by the obligatory, state-owned, pay-as-you-go pension scheme administered by INSS**. Together with the (much smaller) pension scheme for the civil servants and the pension fund for BM employees, the INSS provides the bulk of the nation's obligatory social security system. There are a few corporate private pension funds. The effective number of registered participants is of about 600,000, of which 215,000 are active participants at the INSS, and around 150,000 active participants in all remaining pension plans. The assets under management of the existing pension funds, including the INSS, are estimated at around US$300 million. This figure, however, is based on unaudited financial statements.

44. **The most notable recent change in the sector was the enactment of the Social Security Law of 2007**. The Law extends the obligatory social security system to self-employed workers, and allows a tier of private, supplementary pension funds. In addition, a detailed regulation applying to INSS has been promulgated, limiting administrative expense to 15 percent of revenue; requiring the creation of technical reserves as well as periodic actuarial evaluation of their sufficiency; and the strengthening of INSS's administration (for instance, mandating response timeframes for different requests).

45. **However, implementation of the law is facing difficulties, and there are serious shortcomings in the operation and governance of the sector**. Regulations for the public servants and the BM employee pension schemes and for the supplementary pension funds are still being drafted. There appears to be little interest in the development of supplementary private pension schemes, and INSS suffers from institutional and governance weaknesses.

- *Institutional capacity.* The current institutional capacity of the INSS is weak. Records for the entire system are still manual, although efforts to introduce an IT system are underway. The extension of coverage to the self-employed aggravates the technological and human capacity challenges. As a result, collection and enforcement are very low, especially since there is no cooperation and cross-checking of records with the tax administration.
- *Transparency and accountability.* None of the obligatory pension providers discloses their financial statements. The INSS has not published its financial statements since 2004. The other institutions do not have published audited financial statements. This situation prevents the full determination of potentially significant fiscal and private liabilities.
- *Financial sustainability*. Weak institutional capacity and lack of reliable financial statements precludes an accurate assessment of the financial situation of INSS. It also makes it impossible to determine compliance with the "technical reserves" provision

of the law. In addition, INSS has not adopted an investment strategy and does not apply internationally accepted valuation of its existing investments.

- *Supervisory oversight.* The new law assigns a consultative role to the Consultative Committee of Labor on Social Security matters. However there is no responsible entity to supervise the INSS activities or the other pension funds.

46. **A comprehensive, structured set of interventions is urgently needed to improve the situation of the INSS, which is the backbone of the pension system**.

- *Institutional capacity.* The first priority is to introduce an IT system, improve administration, finalize and publish financial statements, and establish the value of the investment portfolio. Additional financial and human resources may be needed to enable INSS to incorporate the self-employed.
- *Transparency and accountability.* Concurrently, steps should be taken to improve registration of contributors and claimants and strengthen collection of contributions. Cooperation with the tax administration would be key in this regard.
- *Financial sustainability*. Once the financial situation of INSS is clarified, a proper actuarial study should be carried out to assess the long-term viability of the system, with a view to determining whether parametric changes to contributions or benefits are required.
- *Supervisory oversight.* Last but not least, INSS, as well as the other public pension funds, should be subject to independent supervision and develop an explicit investment strategy. Under this strategy, assets of the funds should be invested with the sole objective to safeguard the benefits of future pensioners.

47. **In addition, the government should consider measures to stimulate the development of supplementary private pension funds**. Options include tax incentives and capping benefits under the obligatory tier to encourage participation in supplementary schemes.

E. Insurance

48. **The insurance sector is small**. Total gross premium in 2007 were US$67.5 million, of which non-life accounted for 87.7 percent. This is equivalent to about 0.9 percent of GDP, which places Mozambique behind other markets in the region. The non-life sector is dominated by the motor insurance class, which accounts for about 47 percent of gross premium. Marine insurance, which has significant potential in a country with five major ports, only contributes 2 percent of market premium. There are currently six insurance companies operating in the Mozambican market, five of which are private. Emose, which once held the insurance monopoly, is currently 80 percent state-owned and 20 percent owned by its employees, and has approximately 30 percent share of total market premium.

49. **Since the 2003 Insurance Law, there have been deliberate efforts to improve the regulatory environment; these efforts, however, are yet to yield tangible results**. The 2003 FSAP concluded that key regulations in areas such as risk diversification, solvency of insurance companies, consumer protection, and taxation were lacking, and the capacity of the

insurance regulator (IGS) needed strengthening. Although regulators and the insurance sector have been working on these issues, no new regulations have been introduced. As a result, these shortcomings remain very much in evidence today, and policyholders remain vulnerable: they lack reliable information on products, intermediaries, and insurance companies, while insurers are still short on training and experience, and there are gaps in regulatory coverage.

50. **The key priorities for the insurance sector remain the same as in 2003**. They include the following:

- *Risk management*: While the Insurance Law generally requires that companies manage risk, the IGS does not inspect the risk management practices that companies might have in place;
- *Capital adequacy*: The capital requirements are not related to the size and complexity or risks taken by the company. Currently, the IGS does not test rigorously the adequacy of the financial resources, shareholders, and business plans of insurance companies;
- *Accounting and disclosure standards*: The annual information collected by the IGS is based on the information published annually by the companies and by and large is not in electronic format. This kind of reporting has little value-added and hampers effective offsite supervision;
- *Public awareness and market conduct*: Policyholders and claimants may lack understanding of their rights, and company practices often make it difficult for claimants to file claims.

F. Payments System

51. **Since the 2003 FSAP, Mozambique has made considerable progress in improving its national payments system**. Mozambique introduced the government EFTS in 2004, upgraded the electronic cheque-clearing system, CEL, to allow for electronic clearing by its 17 participants; promulgated the NPS Act in October 2007; strengthened the regulations for interbank clearing and settlement; launched the RTGS project; introduced the STF system, a real-time system used for government payments, including salaries for the civil service; and although still inadequately staffed, the Payments System Division now has a staff complement of 6, instead of 2 in 2003.

52. **In addition, the 2007 NPS Law strengthened the legal basis for the payments system and paved the way for the introduction of RTGS**. Apart from giving the BM explicit powers to oversee the payments system, as well as giving legal basis to some banking processes, such as netting of obligations and truncation of cheques, the Law paved the way for the BM to launch the RTGS system. A 2004 Law allowing the dematerialization of securities is also beneficial to the central securities depository (CSD) operations, and provides for the dynamic management of collateral within the RTGS system and the achievement of delivery versus payment (DVP) in securities settlement.

53. **Pending full implementation of RTGS, the CEL remains the main settlement system, with the BM providing settlement arrangements for participants**. The CEL is used to settle obligations arising from the cheque payment stream, Government EFTS, ATM, and POS networks, and the stock exchange (BVM). Some internal transactions for the BM destined for financial institutions' accounts are also channeled through the CEL System.

54. **In this transitional phase, the key priority is to continue to monitor the risks inherent in the CEL system and complete the implementation of RTGS**. CEL operates on a deferred net settlement (DNS) basis. That is, settlement takes place a day after the transactions are processed through the system. This settlement lag can be a source of liquidity and credit risk which, if not properly contained, can easily translate into systemic risk. The requirement for participants to lodge collateral as a condition for participating in CEL system has never been enforced. Although the introduction of the RTGS system will reduce this risk, the BM should remain vigilant and monitor risks within CEL, especially as long as the latter remains systemically important. Looking forward, regulations that are needed to complete the transition to RTGS should be issued as soon as possible. In addition, greater clarity on the strategy and timetable would be helpful and needs to be supported by definite project plans and continuous dialogue and interaction with market players to ensure a common understanding of both regulatory and operational issues.

55. **In addition to the full implementation of RTGS, other key challenges** are in the areas of oversight, securities settlement, interoperability of cards, and extension of payment services to outlying areas.

- *Although the BM is currently not carrying out the oversight function, there is recognition of the importance of this function in contributing to financial stability*. The BM needs to strengthen its capacity to carry out oversight of the payments system to become effective in executing this critical function. The BM should build capacity in the payments system unit, as well as design and adopt a framework for the oversight of the payments system.
- *The securities settlement cycle should be shortened*. Although the BVM has electronic systems that support its operations, the current settlement arrangements are slow because of the manual intervention required by BM to re-capture net obligations onto the CEL system. The BVM system has the capability to facilitate settlement earlier than the T+3 provided for in the statute. The BM, in cooperation with the BVM and its brokers, should establish the electronic link that would reduce the settlement cycle and facilitate the achievement of DVP.

- *The BM should clarify its position on the interoperability of cards issued by banks and promote the sharing of infrastructure in retail payments*. While some cards are interoperable at the moment, the fees charged for ATM cash withdrawals across banks are high. At the same time, the Bankers' Association of Mozambique is engaged in consultations aimed at possible reduction of fees on ATM and POS transactions. The BM should encourage this and communicate its views to the industry. It should also use moral suasion to get the banks to cooperate through the Payments System Forum.
- *The issue of extending payment services to outlying areas and unbanked communities remains a challenge*. The policy of the BM on participation by mobile phone providers and other third parties in the payments area must be clear and transparent to all prospective providers. The policy should aim to encourage such developments, as they contribute to both efficiency and broader access to financial services.

III. MOZAMBIQUE 2009 FSAP UPDATE—KEY RECOMMENDATIONS

Measure	Timeframe
Access to Finance	
Standardize bank fees, regularly consolidate and publish fee information Expand coverage and range of information collected by the credit registry, ensure legal framework allows private credit registries Computerize and improve efficiency of property registry Review and improve transparency of court fee structure	Short-term
Enact financial reporting legislation covering regulatory aspects of accounting and auditing Discourage mandatory bundling of services by banks	Medium-term
Banking System Soundness and Supervision	
Monitor international exposures and encourage banks to develop a stress testing framework Improve loan classification and provisioning rules and review banks' impaired loan models Introduce remedial action program Issue guidelines for banks on integrated risk management and supervision by risk	Short-term
Regulate and/or develop guidance on interest rate, country, liquidity, and market risk Strengthen crisis preparedness, including internal procedures on emergency liquidity assistance Ensure legal framework allows for flexible resolution tools, including partial purchase and assumption or a bridge bank Introduce deposit insurance after all preconditions are in place Strengthen cross-border collaboration with home country supervisors	Medium-term
Money and Debt Markets and Liquidity Management	
Use overnight repos and reverse repos for BM short-term liquidity intervention Collateralize standing overnight deposit facility Increase stock of outstanding OTs through regular auctions; start issuing fixed rate OTs	Short-term
Extend horizon of liquidity forecast to one year Remove the withholding of tax on repos Issue fungible BTs and OTs and reduce number of outstanding maturities	Medium-term
Pensions and Insurance	
Improve INSS governance through introduction of an IT system, publication of financial statements, and assessment of the value of investment portfolio Publish outstanding regulations for all pension providers Test adequacy of financial resources, shareholders, and business plans of insurance companies	Short-term
Conduct actuarial study of INSS to determine whether parametric changes are necessary Adopt an explicit investment policy for INSS Subject INSS and other pension providers to independent supervision Improve frequency and coverage of data collected by IGS	Medium-term
Payment System	
Complete the implementation of RTGS and monitor risks in the CEL Establish a payment system oversight framework Introduce interoperability of cards and promote infrastructure sharing in retail payments	Short-term
Strengthen the staffing in the Payment System Unit Establish rules for mobile payment provision	Medium-term