Zimbabwe Economic Policy Analysis and Research Unit

Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options

John D. G. Nhavira Evengelista Mudzonga Everisto Mugocha

ACKNOWLEDGEMENTS

ZEPARU acknowledges the financial support provided by the Government of Zimbabwe, African Capacity Building Foundation (ACBF) and USAID Strategic Economic Research and Analysis—Zimbabwe (SERA) Program under contract number USAID-613-C-11-00001, without which this study would not have been possible. This study is part of a broader set of studies on the financial sector development in Zimbabwe commissioned by ZEPARU.

The Study team acknowledges the inputs from diverse stakeholders and colleagues who shared their insights and spared time to provide information and data that was used in this study. Special thanks go to Professor Daniel Makina, Dr. Gibson Chigumira and Dr. Sehliselo Mpofu who reviewed the draft paper during the research process. Comments from Mr. A Ncube of MEFMI and participants of the financial sector studies dessemination workshop held on the 26th of July 2013 at Pandhari Lodge, Harare Zimbabwe are greatly appreciated. The findings of this study do not necessarily reflect the views of ZEPARU or its funding partners. The authors bear full responsibility for any factual errors and omissions.

TABLE OF CONTENTS

ACKNOWLEDGEMENTS ii

EXECUTIVE SUMMARY v

1. INTRODUCTION AND BACKGROUND 1
   1.1 A brief history of the Zimbabwe financial system 3
   1.2 Structure of the paper 8

2. ZIMBABWE'S FINANCIAL REGULATORY AND SUPERVISORY SYSTEM 9
   2.1. The Ministry of Finance 9

3. RATIONALE FOR FINANCIAL REGULATION 11
   3.1 Theoretical perspectives of regulation 17
   3.2 International Best Practice: Evidence and Lessons 18
   3.3 Empirics 18
   3.4 The curious case of Cyprus 21
   3.5 Slovenia on the brink 22

4. HOW EFFECTIVE IS REGULATION AND SUPERVISION IN ZIMBABWE 24
   4.1 Systemic regulation 24
   4.2 Prudential Regulations 32
   4.3 Conduct of Business Regulation 33

5 FINANCIAL REGULATIONS AND CHALLENGES IN SUPERVISION 41
   5.1 Introduction 41
   5.2 Conglomeration 46
   5.3 Macroprudential approach 46
   5.4 Lessons 48
   5.5 Globalisation 48
   5.6 Derivative products 48

6 CONCLUSION AND POLICY RECOMMENDATIONS 49
   6.1 Introduction 49
   6.2 Prudential Regulator 50
   6.3 Market Conduct Regulator 50

7 EMERGING POLICY OPTIONS FOR POLICYMAKERS 53
   7.1 Option one 53
   7.2 Option two 53
   7.3 Option three 53

7.4 Option four 54
7.5 Option five 54

8 FURTHER AREAS OF RESEARCH 55

LIST OF FIGURES

Figure 1: Growth of Banking Institutions in Zimbabwe 1990 – 2013 41
Figure 2: Zimbabwe's Existing Financial Regulatory Structure 62

LIST OF TABLES

Table 1: Soundness of Banks of Selected Countries 6
Table 2: Comparative Zimbabwe Vs South Africa Financial Sector Statistics 7
Table 3: Zimbabwe Financial Soundness Indicators 2009- 2012 30
Table 4: International Comparative Statistics 33
Table 5: Comparative Performance Zimbabwe vs USA Banks 35
Table 6: Herfindahl Hirschman Index for Banks in Zimbabwe Using Loans and Deposit 38
Table 7: Herfindahl Hirschman Index (Hhi) for Six Major Zimbabwe Banks 38
Table 7A: Concentration and Bank Behaviour 39
Table 8: Gini Coefficient for Zimbabwe Banks 39
Table 9: List of Collapsed Zimbabwe Financial Firms 1998-2012 42
Table 10: The Macro and Microprudential Perspectives Compared 46
Table 11: Ownership Structures of Zimbabwe Banks 51

EXECUTIVE SUMMARY

The purpose of this working paper is to critically review the financial regulation and its supervisory architecture in Zimbabwe and settle the question of whether it is still relevant and appropriate for Zimbabwe. In this regard the study is focused on systemic, prudential and market conduct regulation. Regulation refers to the rules that govern the conduct of intermediaries, whilst supervision is the monitoring aspect undertaken by one or more public authorities in order to ensure compliance with regulations. In Zimbabwe there are five principal agencies charged with the responsibility of financial regulation and supervision. These are the Reserve Bank of Zimbabwe (RBZ), The Ministry of Finance, The Deposit Protection Corporation, The Securities Exchange Commission (SEC) and The Insurance and Pensions Commission.

Regulation is necessary to ensure consumer's confidence in the financial industry. There are three main reasons for financial system regulation: (i) to ensure system stability i.e. the safety and soundness of the financial system; (ii) to provide smaller (individuals), retail clients with protection. Caveat emptor does not apply to financial contracts due to their complex and opaque nature, and; (iii) to protect consumers against monopolistic exploitation. The deregulation of the financial sector and emergence of new financial instruments and services offered by financial institutions has blurred boundaries between different types of financial institutions such as banking, insurance and securities.

In order to assess the effectiveness of regulation and supervision in Zimbabwe, we examine the state of three types of regulation: systemic, prudential and conduct of business regulation. A silo-based approach as currently exists in Zimbabwe encourages a blinkered approach to regulation and supervision. The global financial crisis of 2007-2009 has renewed interest in a macro prudential approach to regulation which involves the analysis of macroeconomic trends and how they impact prudential soundness and the stability of financial firms and the financial system. Moreover, the enormous costs of the crisis have forced governments across the globe to reconsider how they approach financial sector regulation. Zimbabwe should not be the exception.

In conclusion the purpose of this working paper was to critically review the regulatory and supervisory regime of the financial system in Zimbabwe and to settle the question of whether it is still relevant for Zimbabwe at this time. It was also observed that there was an absence of a guiding vision for the financial services sector.

The evidence points to the fact that the regulatory and supervisory system is no longer relevant for Zimbabwe as indicated by, inter alias: bank failures due to corporate governance failures, betrayal of fiduciary responsibilities and loss of public confidence in the system brought about by the hyperinflationary episode of

2006-2009. Furthermore, the cause of bank failure may be attributed, in the majority of instances, to a failure of prudential regulation. Most significantly, the financial system has changed through innovations as managers seek to maximize profits through conglomeration. In light of the conglomeration of the financial system and in order to address shortcomings in the regulatory architecture, it is recommended that Zimbabwe consider and adopt one of five options: option (one) calls for policymakers to do nothing; option two requires correcting the weaknesses identified in the various pieces of legislation such as the Deposit Protection Corporation Act, the Reserve Bank of Zimbabwe Act, the Banking Act of 2000 and most importantly, urgently incorporating prudential regulations and guidelines (Basel II and III) into the Banking Act; option three calls for implementing option two and implementing the Integrated Approach; option four calls for implementing option two, then option three- the Integrated Approach and in the long-term implementing the twin peak model. Finally, option five is an option that takes the view that the integrated approach is a stepping stone to twin peaks model.

1. INTRODUCTION AND BACKGROUND

The purpose of this working paper is to critically review the financial regulation and its supervisory architecture in Zimbabwe and settle the question of whether it is still relevant and appropriate (adequate) for Zimbabwe. In this regard the study is focused on systemic, prudential and market conduct regulation.

Systemic regulation is regulation concerned with monitoring, analysis, identifying, curtailing systemic risks across the financial system and organizing the immediate response to a crisis as well as issue periodic reports on the stability of the financial system. Prudential is the regulation of financial institutions through set down requirements, incorporated in the legislation, that limits their risk-taking. This ensures the safety of depositors' funds and maintains the stability of the financial system. Whereas, market conduct (preferably, called financial conduct) regulation constrains a firm's pattern of behaviour in executing its pricing and promotion strategy and its response to the realities of the market it serves. In other words caveat emptor does not apply to financial contracts. On the other hand, supervision is the monitoring aspect undertaken by one or more public authorities in order to ensure compliance with regulations.

In the past four years, (post hyperinflation era) the role of finance and the importance of the financial sector in the Zimbabwean economy has grown substantially (Table 2). For instance, financial assets have increased dramatically relative to Gross Domestic Product (GDP). Finance operates through a complex system of interconnected financial institutions (dealers, banks, insurers), markets (equities, fixed income, futures, derivatives), infrastructures (monetary system, payments and settlements) and interventions by governments as issuers, regulators and participants.

In this vein, the financial system plays a crucial role in supporting and promoting economic activity by facilitating payments, transforming the maturities of assets and liabilities to satisfy the needs of economic agents and facilitating the transferring of funds from savers and investors. Although it is crucial and important, it has vulnerabilities that arise from systemic, prudential and market conduct perspective. These vulnerabilities may result in contagion, turbulence which culminate in loss of confidence in the financial system.

The review is being conducted in the context of a world-wide resurgence in interest in the architecture of financial sector supervisory regimes caused by the 2007-2009 global financial crisis. This interest was initially ignited in 1998 when the United Kingdom (UK) transferred the responsibility for banking supervision from the Bank of England (BOE) to a new institution-the Financial Services Authority (FSA) to which was transferred all the responsibility for supervising all the segments of the financial system- banking, insurance, pensions and securities. Thus the main task of supervising the financial system was assigned to a single authority that was not the

central bank. The UK regime was labeled the tripartite system due to its need for coordination between the FSA, the BOE and the UK Treasury in its quest for financial stability (Masciandaro and Quintyn, 2010).

This notwithstanding, the UK was not the first but due to its status as an eminent international financial centre it generated a lot of interest and attention. The distinction of pioneer in switching to a unified supervisory regime belongs to the Scandinavian countries such as Norway (1986), Iceland and Denmark (1988) and Sweden (1991) (ibid).

Other countries followed suit in adopting the unified supervisory approach based on the UK model, in chronological order: Austria (2002), Germany (2002), Belgium (2006), and Finland (2009). In some jurisdictions, the supervisory responsibilities were concentrated in the central bank, such as Ireland (2003), Czech and Slovak Republic (2006) (ibid).

In sub-Saharan Africa, only Rwanda adopted a unified agency with responsibilities being concentrated in the central bank. South Africa on the other hand adopted the UK model but retained supervision of banks in the central bank and all other segments of the financial system under a new institution –the Financial Services Board (FSB) (refer Appendix 2 which illustrates South Africa's unified approach).

Reform of supervisory agencies has typically followed the aftermath of a financial crisis. The reform has emanated from concern for the health of the financial system. In this regard Zimbabwe has recently emerged from a financial crisis in 2009 after a decade of falling GDP and high persistent inflation culminating in hyperinflation and collapse and abandonment of the local currency in favour of dollarization.

The Zimbabwe financial crisis exposed weaknesses in the regulatory and supervisory regimes. Specifically, the role of the central bank in the genesis of the financial crisis and its sustenance has been well documented in the literature (Henke, 2006; Nhavira, 2009; 2011). It is therefore opportune for Zimbabwe to consider its position and choose an appropriate optimal regulatory and supervisory regime. The search for an optimal regulator is based on the work of Kydland and Prescott (1977) who argued that a policy maker with discretion is unlikely to attain an agreed upon goal. This is also known as policy reversals. The silos model which Zimbabwe uses functions well, according to Masciandaro and Quintyn (2010), provided that the financial industry has distinct demarcations between the operations of banks, insurance, pension funds, and security markets. In Zimbabwe, the boundaries have long since disappeared. Furthermore, in terms of policy it functions well, where the policy is constrained by regulation but in areas where there is none, it fails as regulators engage in competition.

Models of supervisory regimes

Supervisory regimes are grouped along four models one of which, is the functional model is characterized by functions performed by financial firms. Historically it has

had a very limited use. The other models which are generally regarded as the three main models as follows: (i) The vertical/silos model which follows the legal status of the institutions or business type viz banking, securities, insurance and pension sector with each sector supervised by a different agency; (ii) the horizontal (or peaks) model which is identified by objectives of regulation and where each objective is supervised by a separate authority (the twin peaks model, Taylor, 1995); and (iii) the unified (or integrated) model, in which a single authority supervises the whole financial system and all the public objectives.

South Africa (FRRSC, 2013) has already commenced the process of reorganizing its regulatory system (into twin peaks model) in keeping with objectives-based regulation (i) prudential regulation; (ii) business conduct regulation and consumer protection regulation; and (iii) market stability measures. In the meanwhile the UK has begun implementing this model introduced to parliament in bill on the 4th of February 2013 (BOE, 2013).

Detractors of reform argue that consolidated supervision of conglomerates is sufficient and there is no need for reform. This is misguided. Conglomerates arise for the following reasons: pursuit of diversification of risk and revenues; pursuit of market power; and the pursuit of efficiency through reduced costs, reduced prices and the increased cross-selling of products and services (Martinez, 2010). Financial conglomerate supervision "is a comprehensive approach to banking supervision which seeks to evaluate the strength of an entire group, taking into account all the risks which may affect a bank, regardless of whether these risks are carried in the books of the bank or related entities." (BOE, 1998). Based on data from Financial assessment programme, Martinez (ibid) concludes that "consolidated supervision is a complement and not a substitute, of solo supervision."

Having said that, it is equally important that there be a vision (Nhavira, 2012) of where the economy is expected to be heading, say, in 20 years time and accordingly design the financial system accordingly. That is very important in order to avoid rudderless drifting. This, in turn, would unlock the objectives the financial system is expected to serve or achieve as milestones along that journey (Nhavira, 2012).

1.1 A brief history of the Zimbabwe financial system

Zimbabwe's current financial regulation and supervisory architecture was inherited from the Rhodesian Government at independence in 1980. Specifically, the Reserve Bank of Zimbabwe, the Commissioner of Insurance and Pension Funds and the Zimbabwe Stock Exchange as regulator of the capital markets. Since then, the financial system has undergone several changes in recent years. The Commissioner of Insurance was superseded by The Insurance and Pension Fund Commissioner through Act 7 of 2000 and The Zimbabwe Stock Exchange has been superceded by the Securities Exchange Commission through the Securities Act 17 of 2004. This regulatory and supervisory regime served Zimbabwe well until 1990 as the financial sector was stable and witnessed no financial crisis or bank collapses.

1.1.1 Economic Structural Adjustment Programme

In 1991, the government of Zimbabwe embarked on an Economic and Structural Adjustment Programme (ESAP), part of which was the implementation of financial reforms through liberalisation and deregulation. The main argument was that the oligopolistic nature of the banking sector inhibited competition among the players in addition to depriving the sector of choice and quality in service, innovation and efficiency. The government through the Ministry of Finance and the RBZ began issuing out new licences to financial players such that between 1993 and 2003, there was an upsurge of banking institutions. Figure 1 shows that in 1990 before the financial reforms, there were only 21 banking institutions. In 1993, they had increased to 23 and by 2003, before the banking institutions collapse, they had increased to 41. There were only 6 commercial banks and 2 discount houses, 3 building societies, 5 finance houses before financial and 5 merchant banks before reforms in 1990. By 1998 the number of commercial banks had increased to 7. In the same year United Merchant Bank owned by Roger Boka collapsed. Between 2000 and 2003 the number of commercial banks increased from 12 to 17 respectively. In 2004 4 banks collapsed, but thereafter, the number gradually increased to 17 as merchant banks converted into commercial banks. As for the discount houses, they had increased to 8 in 2003 thereafter steadily declining to zero in 2010. A similar trend is also noticed on the finance houses. Since liberalization, entry into the market by foreign banks has been limited due to restrictions such as minimum 30% local shareholding as well as stringent foreign currency controls in addition to caution amongst the licensing authorities to issue licences to foreign banks thus most of the entrants were local.

In 2000, the Banking Act was amended, thereby making it possible for banking institutions to transform into commercial banks by acquiring additional functions on their licences. The transformation of the financial landscape in Zimbabwe was a reflection of the effects of deregulation and liberalization that occurred through the removal of market segmentation and removal of controls on interest rates and quantitative credit controls. Of significant importance was the relaxation of entry into the financial services sector.

1.1.2 Conglomerates

At the same time the financial services sector observed the emergence of financial conglomerates, boundaries between the different types of financial institutions such as banking, securities and insurance have disappeared (Taylor and Fleming, 1999). For instance, Bancassurance a banking model where a commercial bank actively distributes insurance products has become prevalent in Zimbabwe. Moreover, the housing of securities trading under conglomerates has compounded an already complex situation. The introduction of innovative financial products such as ecocash, textacash, mobile banking and internet banking has added further sources of fragility and has raised issues of how these conglomerates should be supervised.

1.1.3 Innovation

Some of these innovative products such as "textacash" and " ecocash" and mobile banking have come about due to technology being available as well as due to loss of confidence in the banking system and to address issues of financial inclusion (Finmark survey, 2012). Several factors contributed to the loss of confidence: hyperinflation, which culminated in the loss of 100 years of savings. After dollarisation the loss of Zimbabwe dollar savings, the murky conversion of pensions and life assurance proceeds into US dollars; high bank charges coupled with zero interest rates on positive balances in bank accounts and high punitive interest rates on loans and overdraft further undermined confidence in the financial system. The slow response of the Reserve Bank and the Ministry of Finance to issues of market conduct and protecting bank customers from the rapacious behavior of financial system players drove many from the financial system and encouraged the reversion of the Zimbabwe economy to a more primitive one reliant on cash-based-transactions.

1.1.4 Offshore Accounts

Technology also introduced greater choice in the form of non-resident bank accounts or off-shore accounts and services. These products operate via global VISA, MASTERCARD and SWIFT networks that straddle the globe. This means that weaknesses in the domestic financial services sector, may not result in campaigns for reform but will swiftly result in transfer of funds off-shore. Therefore, Zimbabwe's financial services sector and institutions must have flexibility, compete both at home and abroad so as to retain their critical role as sources of economic activity and employment creation.

This lack of confidence has not been confined to the Zimbabwean domestic market players but has affected international banks wishing to do business in Zimbabwe as reflected in the high risk premium they demand for their short-term funds. However, the most dramatic dent to confidence occurred with the spectacular collapse of two financial institutions that were regarded quite highly in the market, Renaissance and Interfin. There was no indication that they were having any serious problems (MPS,2011, 2012).This situation is placed in perspective when Zimbabwe is ranked against other selected countries in the world.

This fall in confidence has not occurred dramatically and suddenly but has been building up gradually over a period of time. According to the World Economic Forum Competitive Survey, of 2012/13, Zimbabwe banks ranked 135 out of 144 banking sectors in the world in terms of soundness.

Table 1: Soundness of Banks of Selected Countries

2011 - 2012			2012 - 2013		
Country	Rank	Value	Country	Rank	Value
Canada	1	6.8	Canada	1	6.8
South Africa	2	6.6	South Africa	2	6.7
Luxemburg	23	6.0	Luxemburg	18	6.1
Cyprus	48	5.6	Cyprus	83	4.9
Zambia	61	5.4	Zambia	64	5.3
United States	90	4.8	United States	80	5.0
Greece	106	4.6	Greece	141	3.1
Zimbabwe	130	3.9	Zimbabwe	135	3.7

Source: The Global Competitiveness Reports 2011-2012 and 2012 -2013

The ratings value range from 1 to 7. Based on this measure a rating of 1 means that the banking sector is insolvent and may require bail out while a rating of 7 reveals a generally healthy banking sector with sound banking balance sheets. Table 1 illustrates that Canada ranked top as the country with sound banking system out of 144 countries between 2011 and 2013 followed by South Africa and Luxemburg. In fact, the latter two countries in addition to the United States improved their ranking scores over this period. The soundness of banking sectors of Cyprus, Zambia, Greece and Zimbabwe weakened during the period (see Table 1).

Zimbabwe was ranked 109 on financial market development ahead of Slovenia and Greece that were ranked 128 and 132 respectively. South Africa was however ranked 3rd while Luxemburg, US, Cyprus and Zambia 12th, 16th, 38th and 50th respectively.

Further comparison of the financial sector is made against South Africa, with a GDP of USD300bn against Zimbabwe's USD10bn.

Table 2: Comparative Zimbabwe Vs South Africa Financial Sector Statistics

Component	South Africa %share of GDP(2010)	Zimbabwe % Share of GDP(2000)	Zimbabwe % share of GDP(2012)
Size(gross value added)	10.5	n/a	n/a
Assets	252	252.7	89.92
Of which:			
Banks	127	201	62.5
Long term insurers	60	23.5	12.1
Short term insurers	4	1.2	n/a
Pension funds (public and private)	62	28.0	15.2
Employment	Share of formal 3.9		n/a
Tax contribution	Share of corporate taxes 15.3		n/a

Source: National Treasury Policy Document (2000, 2004, 2012) and Zimbabwe data Reserve Bank of Zimbabwe and Insurance, Pensions Commission

Table 2 illustrates that the financial sector operates at the heart of the financial system and it is therefore important that it be financially stable in order to buoy the growth of the real economy. South Africa is regarded as being financially stable with assets more than 2.5 times its GDP. In contrast to Zimbabwe financial sector assets were only 89.92 per cent of GDP. Long term insurers- the backbone of the long term end of the market account for 60 per cent of the South African GDP. In Zimbabwe this was only 12.1 per cent of GDP. This compares unfavourably with the year 2000 when bank assets were 252.7 per cent of GDP; long term insurers were 23.5; short term insurers; 1.2 and pension funds as a proportion of GDP were 28 per cent respectively. Apart from short term insurers who surprisingly have grown 12.5 times more than they were in the year 2000 the year when land invasions started. The findings when contrasted with 2012 appear consistent with our assertion of a lack of confidence in the financial services sector.

Overall there is a lack of confidence in the insurance sector following the collapse of the Zimbabwe dollar. Additionally, the selling of bad products to the public in the wake of dollarization had taken its toll, such as demand deposits to all and sundry, funeral policies, vehicle recovery, membership fees to access certain types of services, such as executive banking, credit insurance, and life cover even for loans below USD5000. Most damaging of course are the high bank charges currently obtaining (MPS, 2013). At the time of writing, there are unsubstantiated reports that some USD 650 million dollars had left the country in the first half of the year 2013. Requests for monetary aggregates from the Reserve Bank of Zimbabwe, who are normally cooperative, has gone unheeded.

It is against this background that this study is being conducted to determine if the regulatory and supervisory structure is still relevant and appropriate for Zimbabwe. In this regard the study is focused on systemic, prudential and market conduct regulation. This study seeks to answer the question: is the current financial regulation and supervisory regime still relevant today?

This paper is justified in the light of the many events that have conspired to undermine confidence in the financial system. The financial system is ranked 109th in the world and its financial system undercapitalized. It has been undermined by inappropriate monetary policy, inflexible in the face of international competition, in a global market place where borders are no hindrance to the provision of financial services. The study will determine those matters to be addressed in order to restore confidence locally and internationally and catalyse a reduction in risk premium as demanded by domestic consumers and international financiers alike.

1.2 Structure of the paper

The rest of this paper is structured as follows. Section 2 examines the current financial regulatory and supervisory system; followed by section 3 which reviews the rationale for financial regulation. Section 4 examines Zimbabwe's financial regulation and supervisory system while section 5 discusses the effectiveness of the regulatory environment. Section 6 examines the challenges faced by supervisors. Finally, section 7 concludes and makes recommendations.

2. ZIMBABWE'S FINANCIAL REGULATORY AND SUPERVISORY SYSTEM

In Zimbabwe there are five principal agencies charged with the responsibility of financial regulation and supervision. These are the Reserve Bank of Zimbabwe (RBZ), The Ministry of Finance, The Deposit Protection Board, The Securities Exchange Commission (SEC) and The Insurance and Pensions Commission (Figure1 illustrates the current financial regulatory structure in Zimbabwe).

2.1. The Ministry of Finance

The Ministry of Finance is the ultimate supervisor of the financial system. In other words, all the regulators and supervisors of the financial system fall under the purview of the Ministry of Finance.

2.1.1 Reserve Bank of Zimbabwe

The Reserve Bank of Zimbabwe (RBZ) is the primary institution responsible for the regulation and supervision of banks. It was not always that way. Prior to 2000 registration of banks was the responsibility of the Ministry of Finance whilst supervision was the purview of the Central Bank. However, the Banking Act of 2000 and Statutory Instrument 205 of 2000 transferred all responsibility to the Reserve Bank of Zimbabwe but by 2004, the Reserve Bank was required to consult with Ministry of Finance before withdrawing a bank licence. By 2006 the Central Bank adopted the risk-based supervision of banks. Moreover, the Reserve Bank of Zimbabwe was responsible for ensuring that Zimbabwe's financial system remains up-to-date with International Standards that are set by the Bank for International Settlements. However, to-date Zimbabwe is yet to fully implement the Basel II Accord. Implementation has been hampered by the 2000-2008 economic crisis and more recently by the liquidity problems bedeviling the financial sector (see views from Banking sector players in Appendix 3).

Under the RBZ Act, the RBZ is empowered to supervise the operations of all banks in the country. Its Bank Supervision and Surveillance department scrutinizes periodic returns under its risk-based-supervision (off-site examination) and undertakes regular examinations of the books and records of the bank through on-site examinations in order to ensure conformity with statutory regulations as well as with RBZ Prudential Guidelines. However, it is not an independent Central Bank and its objectives are, inter alias, not narrowly focused on price and financial stability (Nhavira and Pindiriri, 2011).

2.1.2 The Deposit Protection Corporation

The Deposit Protection Corporation that came into being through Act 7 of 2010 is tasked with the responsibility of protecting depositors thereby ensuring safety and soundness of the banking system by preventing bank runs. Moreover, the Corporation will have power to obtain information from financial institutions that

will allow it to detect early signs of difficulties within the financial system; the Corporation will also be given power to administer failed or failing institutions and, where possible, restore them to financial health. The Deposit Protection Fund was established in 2003 in terms of Section 66 of the Banking Act Chapter 24:20 as read in conjunction with Section 4 of the Deposit Corporation Act Chapter 24:29 of 2011.

Membership is mandatory and premiums are levied at a rate of 0.03 per cent per annum or 0.075 per cent per quarter with a minimum and maximum contribution of USD500 and USD 30 000 respectively. The current maximum insurable limit is USD150.00 per depositor per bank.

Deposit accounts which are covered by the scheme include; demand, time and savings deposits; class B and class C shares of building societies. However, interbank deposits, negotiable certificates of deposit and banker's acceptances are excluded. The cover provided secures individuals, corporate and trust accounts.

2.1.3 The Securities Commission

The Securities Act (SA) 24: 25 took effect on 01 June 2008. It governs the regulation of securities services in Zimbabwe to include securities exchanges, Central Securities Depositories (CSDs) and the respective members, misuse of inside information, and improper trading practices. The securities Act does not apply to Collective Investment Schemes investments regulated by the Collective Investment Schemes Act [Chapter 24:19] (Act No. 25 of 1997).

The Securities Exchange Commission (SEC) was formed with the following objectives inter alias; investor protection, reduce systemic risk, and promote market integrity.

2.1.4 The Insurance and Pensions Commission

The Insurance and Pensions Commission (IPEC) was formed with the objectives, inter alias, of regulating and monitoring the insurance and pension industries in Zimbabwe.

It is clear from the foregoing multiple regulators that the regulation and supervisory architecture in Zimbabwe is based on the silo approach i.e. determined by the type of institution or functional lines-such as banking, insurance and the securities industry determining under which regulator they fall under. As a point of fact securities trades now transcend the securities industry to encompass the entire financial system. Furthermore, there is no harmonization of accounting practices. For instance IPEC wants returns at cost whilst banking insists on mark-to-market.

3. RATIONALE FOR FINANCIAL REGULATION

Banks attract intense regulatory attention because unlike other businesses they possess certain features which justify this regulatory attention. First, banks are the only financial institutions legally empowered to accept demand deposits which are bank accounts transferable from one economic agent to another. However, demand deposits are also available for transaction purposes, thereby placing banks in a central position in an economy's payment system. Secondly, banks act as depositories for economic agents which make them bank creditors. Thirdly, banks play a major role in the allocation of credit as they are a major source of loanable funds to all economic agents and government. Bank credit is therefore crucial in the financing of investment, consumption and government expenditure. Fourthly, banks have the ability to create money as a result of demand deposits, they can expand the money supply by opening new accounts to loan customers. In turn, this capacity to expand money supply has serious implications for the formulation and implementation of monetary policy and by extension, for the stability of the whole economy.

Table 2 illustrates the importance of the financial sector to Zimbabwe. Zimbabwe's financial sector assets are 89.2 per cent of GDP. Compared to South Africa they have the potential to reach 252 per cent. Zimbabwe banks asset share of GDP are 62.5 per cent with a potential to expand to 127 per cent share when compared to South Africa. Long-term insurance and pensions, in Zimbabwe are really underperforming at a paltry 12.1 and 15.2 per cent share of GDP respectively. South Africa on the other hand, the share of GDP for long-term insurance and pension funds is 60 and 62 per cent respectively. The reasons for this are clear-the financial instability of 2000-2008 period which seriously dented the public trust and confidence in the financial sector.

The reality is that financial systems all over the world are prone to periods of instability. Zimbabwe is no exception to the rule. Consequently, in 2009 following dollarization of the economy, the financial system was once again in crisis due to low capitalization levels. A number of financial institutions should have collapsed due to low capitalization but the regulators looked aside paving the way for banking firms to recoup lost capital through two paths; high bank charges and high interest rates which were at times in excess of 75 per cent per annum in 2009 (MPS,2009;2010;2011;2012 and 2013).

The incidents of failure or financial crises and such extra-statutory taxation have led some to argue that this suggests a case for more effective regulation and supervision. On the other hand, others attribute many of these crises and lapses to the failure of regulation. On the extreme end, advocates of "free-banking" argue that the financial system is better off without regulation, supervision and central banking. Without government regulation, they contend, banks would have greater incentives to prevent failures.

Indeed, banks are more prone to financial trouble than other firms because of their activities (illiquid assets and short-term liabilities). Moreover, due to the interconnectedness of financial institutions, the failure in one institution can immediately affect another. This is known as contagion and may lead to bank runs. Financial systems are therefore subject to systemic risk. In fact a banking institution is really a legalized Ponzi scheme which relies on confidence of the public for its continued existence.

Regulation is therefore, necessary to ensure and maintain consumer's confidence in the financial industry. There are three main reasons for financial system regulation:

(i) to ensure system stability i.e. the safety and soundness of the financial system ;
(ii) to provide smaller (individuals), retail clients with protection. Caveat emptor does not apply to financial contracts due to their complex and opaque nature, and;
(iii) to protect consumers against monopolistic exploitation.

From these three major reasons for regulation emerge three regulatory types:

Systemic Regulation
This is concerned with public policy regulation designed to minimize the risk of bank runs and encompasses two main features viz. deposit insurance which is a guarantee that all or a part of the amount deposited by individuals will be paid back in the event of failure and the lender of last resort (LOLR) function which is a major function of a Central Bank. However, different arrangements are required with regard to LOLR when the economy has dollarized as is the case of Zimbabwe.

Prudential Regulation
This is mainly concerned with consumer protection. It envisages the monitoring and supervision of financial institutions, with particular attention being paid to asset quality and capital adequacy.

The rationale for prudential regulation is that consumers are not in a position to judge the safety and soundness of financial institutions arising from imperfect consumer information and agency problems associated with the nature of financial intermediation. In Zimbabwe prudential regulations is the purview of the Reserve Bank of Zimbabwe and aims to ensure that the firms it regulates are financially sound. This includes specifying standards covering risk management and other related requirements.

Conduct of Business Regulation
This focuses on how banks and financial institutions conduct their business. It suggests two key requirements –clear direction from the regulator and alignment by regulated firms of the interests of customers, advisors and shareholders. This form

of regulatory intervention relates to information disclosure, fair business practices, competence, honesty and integrity of financial institutions and their employees. It therefore focuses on establishing rules and guidelines to reduce the probability that:

(i) consumers receive bad advice (agency problem);
(ii) supplying institutions are insolvent prior to maturity of the contract;
(iii) fraud and misrepresentation may take place;
(iv) employees of financial institutions (intermediaries) and financial advisors act incompetently;
(v) contracts turn to be different from what the customer was anticipating.

It follows from the above that the regulatory and supervisory attention focused on banks is far from misplaced. Banks in this context represent channels through which monetary and credit policies are implemented and their welfare (health) significantly affects the nation's level of employment and income. Regulations of banks have been both wide and varied, covering their portfolio decisions, the price they can charge and the prices they can pay. Regulations also cover who can open banks and the nature of the products offered.

Role of the Bank for International Settlement (BIS)

The importance placed on the international financial system is highlighted by the work of the Bank for International settlements (BIS) based in Basel, Switzerland. "The mission of the Bank for International Settlements (BIS) is to serve central banks in their pursuit of monetary and financial stability, to foster international cooperation in those areas and to act as a bank for central banks" (BIS.org).

It monitors the international financial system for threats to stability to ensure that it is stable through research and regular meetings of central bank Governors and senior officials of member central banks. Consequently, the BIS takes a keen interest in understanding financial crises regardless of wherever they may occur in the world. To the BIS each financial crisis is a learning point and a stepping stone to new regulation and strengthened supervision which is epitomized in the series of standards/Capital Accords- Basel I, II and III. These are designed to ensure the maintenance of financial stability. However, the IMF and the World Bank play various roles through IMF Annual reports and Financial Sector Assessment Programme.

The first efforts to encourage convergence towards common approaches and standards at the international level were initiated by the Basel Committee on Banking and Supervision in 1970's (Goodhart, 2011). Since then capital adequacy standards and associated regulation have been important policy issues and fundamental components of bank regulation. The BIS is also home to the Financial Stability Institute and the Committee on Payment and Settlement Systems.

Other models of regulating the financial sector

Accordingly, over time regulation and supervision models have evolved into several forms such as; the institutional approach involving entities being regulated on the basis of their legal form; the functional approach involving entities being regulated on the basis of the functions they perform; and the integrated approach (also known as the 'single' peak model (G30, 2008).

However, the evolution has not ended there progressing the twin peaks model which was initially implemented in Australia and Netherlands as far back as 2002. This involves the establishment of two regulators; the first being responsible for prudential regulation and the second institution being responsible for supervising financial market conduct and consumer protection. New Zealand is taking steps to implement this model (Bailey, 2010) which is regarded as "an effective allocation of regulatory responsibility when compared to alternative models" (Martinez et al, 2003). The approaches described above as contained in the G30 (2008) report, which was based on a review of 17 national supervisory and regulatory approaches are explained in greater detail as follows:

Institutional Approach

The institutional approach refers to a firm's legal status deciding which regulator is responsible for overseeing its activity from both a safety and soundness and a business conduct angle. Examples include, banks, stockbrokers or securities dealers or insurance and assurance companies. The report recognizes the weaknesses inherent in this approach and suggests the use of coordination mechanisms being employed to overcome them. Moreover, this structure is regarded as sub-optimal. Countries that employ this structure include, China, Hong Kong and Mexico.

Functional Approach

Supervisory oversight, in this case, is decided by the business that the institution is involved in, rather than its legal status. Consequently, each type of business may have its own functional regulator. As in the institutional approach, it also requires coordination mechanisms and is also regarded as a sub-optimal approach. Countries which practice this approach include Brazil, France, Italy, Spain and Zimbabwe.

Integrated Approach

The integrated approach is one in which a single overarching regulator is responsible for both safety and soundness supervision and conduct of business regulation for all the sectors of financial services business. It is regarded as effective and efficient in small markets. One of its advantages is that it has a single focus on regulation and supervision without the confusion or conflict over jurisdictional lines that arise under the other two approaches described above. However, its single point of focus has been identified as a point of contention, that it is its major weakness and

may be the cause of future regulatory failure. Countries employing this approach include Canada (whose banking system is rated no.1), Germany, Japan, Qatar, Singapore, Switzerland and United Kingdom. In addition to the countries cited by the G30 report, South Africa (Treasury Report) also used this approach until recently when it decided to adopt the twin peaks approach as did the United Kingdom and New Zealand.

The case for a single regulator

Two arguments are generally proffered in favour of a single regulatory agency. The first is to enhance the overall supervisory capacity of the financial sector. Multiple supervisory bodies have been found to be inept in forming an overarching risk assessment of a financial conglomerate due to a range of sources of financial risks associated with each different segment of the institution. Therefore an integrated financial sector supervisory body- in which banking, securities, and insurance regulations are combined within a single institution-has emerged as a preferred choice to deal with a complex financial system.

Furthermore, under a system of multiple supervisory bodies, accountability may be easily diffused in cases of regulatory failure at any of the independent supervisory agencies, and that a lack of harmonization in the regulations and in their implementation across institutions may arise. Consequently, a sole supervisory agency is best positioned to monitor the financial system as a whole, thereby minimizing regulatory arbitrage through application of a consistent approach to regulation and supervision across segments of the financial system (Martinez and Rose, 2003). In any case, a single supervisor is to be preferred from the perspective that they are better placed to follow a trail to its logical conclusion regardless of whether it leads them to an insurance entity or securities firm.

A sole supervisor is able to achieve higher economies of scale through centralized regulatory functions that permit the development of joint administrative, information technology and other joint support functions is compelling reason enough to establish a sole supervisory agency (Fleming and Taylor, 1999).

Another argument has emerged from the current financial crisis engulfing Greece, Cyprus and possibly Slovenia. Multiple regulatory supervisors are more likely to fall prey to financial crisis.

Finally, for the avoidance of doubt, sole supervisor means a supervisor who is responsible and accountable for one aspect of regulations across financial sector institutions such as either prudential regulation or conduct of business regulation. In other words the supervisor becomes specialized and therefore more efficient. Moreover, it allows for streamlining and reduces duplication of functions and hence wastage of resources and encourages the sharing of scarce resources.

Concerns about a sole supervisor
There are generally three concerns highlighted in the literature (Siregar and James, 2006):

The first is that once established, its success depends on the strength of the pre-existing multiple supervisory agencies. Secondly, Martinez and Rose (2003) found an array of problems during the transition period, such as, legal constraints, personnel, integration of information technology systems, and budgetary issues may slow down the establishment of the supervisory agency and that may lengthen the transition stage of the single institution. Thirdly, Reddy (2001) noted that unification could lead to lack of clarity in functioning due to conflicting objectives associated with different supervisory roles, furthermore power may become concentrated in a single entity (Goodhart,2001; Barth et al.,2001).

Twin Peaks Approach
This is a type of regulation by objective where there is a demarcation of regulatory functions between two regulators: the first oversees the safety and soundness supervision function and the other to focus on conduct of business regulation.

This is regarded as hybrid approach which is designed to achieve the benefits and efficiencies of the Integrated Approach, while minimizing the conflicts that may arise between the objectives of safety and soundness regulation and consumer protection and transparency. Countries identified as using this approach were Australia and the Netherlands. It is regarded as optimal due to its success in mitigating the effects of the 2007-2009 financial crises, a number of jurisdictions are in the process of moving to this approach. These include, France, Italy, Spain, the United States, United Kingdom (the UK Financial Services bill came into force on 01 April 2012) and South Africa.

In conclusion, the rationale behind banking regulation is, inter alias, the existence of market imperfections and failures, potential systemic problems that require protection of consumers through monitoring of financial firms and ensuring consumer confidence (Botha and Makina, 2011; Casu et al, 2006).

It is important, to emphasize that the above approaches represent an evolution based on the market "feeling" its way in search of the optimal regulatory structure that will put an end or mitigate financial crises. Minsky (2008) observed that the financial system is prone to financial instability as a consequence of the profit maximization seeking behavior of management.

Determinants of Regulatory and Supervisory Reform
Financial crises have a strong impetus for reform of regulation and supervision (Masciandaro and Quintyn, 2009). This concern for the health of the banking and financial system causes renewed interest and debate in the regulation and supervisory settings.

On the other hand Goodhart and Schoenmaker (1995); Llewellyn (2005); Herrings and Carmassi (2008) contend that the more the central bank is involved in supervision, the greater the risks of conflict among different goals and increases in moral hazard. A further determinant is that by their nature failures are more visible than successes, and allowing a central bank to be deeply involved in supervision may damage its reputation (Goodhart, 2000).

3.1 Theoretical perspectives of regulation

Financial regulation and supervision is usually left to government agencies that promulgate regulations, prescribing, proscribing and conditioning the behaviour of individuals groups and firms. Their decisions have a greater impact than those of the three executive branches of government. The question is their influence for good or bad? Their power, ability to close a financial institution and dispossess the savings of millions immediately raises questions about its efficacy and even their political legitimacy.

Given the foregoing, how then is the existence of these agencies such as the Central Bank justified? One plank is that they correct market failures as agents of the citizens according to Levine and Florence (1990).

Consequently, a complete picture of the regulatory state is necessary in order to have distinct answers to questions about the regulatory state , what it does, what it is capable of doing, and what types of regulatory reforms would be desirable or appropriate. Theories of regulation by their definition seek to ultimately explain agency decisions.

Generally, according to Croley (1998) there are four theories of regulation:

3.1.1 Public Choice Theory,

The public choice theory challenges the idea that agencies' genuinely respond to market failures. Rather they deliver regulatory benefits to well organized political interest groups which then profit at the expense of the generally unorganized public.

3.1.2 Neopluralist Theory,

This theory considers organized interest groups to be central to understanding regulation. However, under this theory many interest groups with opposing interests compete for favourable regulation. The result is that interest-group competition crudely reflects general interests.

3.1.3 Public Interest Theory

The public interest theory concentrates on the general public's ability to monitor regulatory decision makers. Where regulatory decision makers operate under conditions of significant public scrutiny, the public interest theory holds that regulatory outcomes tend to reflect general interest. Where on the other, hand,

the relevant decision makers operate without any oversight, they tend to deliver regulatory benefits to well organized interest groups at the public's expense.

3.1.4 Civic Republican Theory.
This theory postulates that agency decisions, at least potentially, embody the policy's judgments about how competing regulatory values –safe and sound financial system versus consumer convenience, for example are to be balanced. Regulation therefore, provides occasion for collective deliberation about regulating means and ends.

In conclusion the relevance of these theories to Zimbabwe is that they explain and offer guidance on the appropriate regulatory and supervisory regime. It must be one that serves the general interests of society. However, due to the existence of the agency problem it is necessary that the regulator and supervisor should be monitored through some oversight committee to ensure that they are pursuing the general interests of society and not their own or for any vested group interests for that matter.

3.2 International Best Practice: Evidence and Lessons

The emergence of new financial instruments and services offered by financial institutions has blurred boundaries between different types of financial institutions such as banking, insurance and securities.

3.3 Empirics

Experience from three Scandinavian economies (Denmark, Norway and Sweden) Taylor and Fleming (1999) showed that an integrated system has been observed to improve the standing of supervisory agencies because of its independence. An integrated system has also been found to respond more flexibly and rapidly to changing market circumstances and conditions.

Characteristics of an effective single regulator

3.3.1 Legal and political issues
A new law on the single supervisory agency should be proposed and passed by parliament.

3.3.2 Independence
An effective supervisory agency must be independent i.e. able to take decisions and discharge its duties without undue outside influence either from politicians, industry leaders or parliamentarians.

3.3.3 Budgetary Issues
Since budgetary issues have an impact on independence of the single supervisor, it is important that the supervisory agency has an adequate and stable source of funding. For instance the Financial Services Authority (FSA) in the United Kingdom is

funded entirely through an industry levy. In Korea, on the other hand, the principal sources of funding for the Financial Supervisory Service are appropriations from the government, the Bank of Korea and the financial institutions under its authority.

3.3.4 Accountability

Accountability for policies and actions and omissions is necessary to temper independence. In the recent past, we have observed how the actions and inactions of the supervisor had substantial impacts on the markets, the overall macroeconomic environment. Therefore it is imperative that there be a committee comprised of representatives from the financial industry, the government, the Central Bank and parliament to periodically review/evaluate the performance of the supervisory authority.

3.3.5 International Trends

International trends post 2007-2009 financial crisis indicates a move toward the twin-peak model. The United Kingdom, New Zealand and South Africa, after the global financial crisis, are moving toward a twin-peak model. Twin-peak refers to the existence of two regulators. That is one will be a regulator for prudential regulation (usually the central bank)(in the UK model, a separate regulator/ subsidiary of the central bank) and a regulator for market conduct (each regulator specializes in its area and supervises, banks, insurance, pension funds and securities firms falling under its purview). It is regarded as the optimal means of giving sufficient priority to transparency, market integrity and consumer protection (Botha and Makina, 2011; National Treasury, 2008). The Twin Peaks Approach is designed to attain many of the benefits and efficiencies of the Integrated Approach, while at the same time addressing the inherent conflicts that may arise from time to time between the objectives of safety and soundness regulation and consumer protection and transparency.

When prudential concerns appear to conflict with consumer protection issues, the prudential supervisor in the twin peaks system may give precedence to safety and soundness mandates, because these are closely intertwined with financial stability. The Twin Peaks Approach may help to force a resolution to this conflict. Zimbabwe's system of financial regulation has been linked to South Africa, the United Kingdom and other former British colonies such as Australia and Canada whose regulation systems had been reformed prior to the global financial crisis.

Bailey (2010) cites the following arguments for and against the twin peaks model:

For	Against
Reduces the risk of regulatory overlap and duplication that can arise with multiple regulators and, conversely, the risk of gaps in regulatory coverage and enforcement	To some degree, the risk of regulatory overlap and duplication, and the risk of gaps in coverage, can be addressed through effective coordination, information sharing and collaboration, among existing regulatory agencies.
Strengthens the accountability of the regulator (accountability does not diffuse across multiple regulators) and reduces the potential for blame-shifting.	A single regulator for market conduct has the potential to reduce the checks and balances available in a system of multiple regulators with a heightened risk of over-regulation or excessive use of powers.
Increases economies of scale and scope in market supervision, potentially contributing to better use of resources, regulatory effectiveness and reducing administrative costs. This is particularly important to a small country and financial market such as New Zealand.	Gains from economies of scale and scope may not be significant.
Allows development and implementation of a unified and consistent approach to market conduct regulation, supervision and enforcement across the entire financial system, reducing regulatory arbitrage.	Risk that new single regulator for market conduct fails to develop a consistent framework of regulation and enforcement for financial sector.
Allows better monitoring of issues affecting the entire financial system, as well as rapid policy responses.	Integrated market conduct regulator may become excessively bureaucratic in its procedures and slow to react to problems as they emerge.
Facilitates the regulation and supervision of financial conglomerates, where financial firms are operating in more than one segment of the financial market.	The risks associated with merging multiple regulators and functions may not be properly managed (for example, transitional issues, the merging of different cultures).
Eliminates potential conflicts that can arise from different regulatory objectives between multiple regulators.	There is a risk that a single regulator does not recognize the unique characteristics of different financial intermediaries and products.

Clearly, from the foregoing, the arguments for far outweigh those against given the growing interest by various jurisdictions to adopt and implement this model. Furthermore, the escape unscathed of Australia and Netherlands from the 2007-2009 financial crisis has added to its attraction as the model to adopt.

Accordingly, England's Prudential Regulatory Authority justifies its existence as follows:
"It provides a solution for 'collective action' problem i.e. the risk that the failure of one firm could cause wider disruptions to the system thereby reinforcing expectations of the state providing solvency support. Prudential regulation can help address this problem" (BOE,2013).

Prudential regulation helps address the moral hazard problem potentially posed by deposit guarantees and central bank liquidity insurance. Another moral hazard problem is that of the risk that deposit takers and investment firms potentially pose to the stability of the system. For instance, disruption to the payment system curtails the depositor's ability to undertake economic activity. This may severely affect the supply of credit to the economy.

Separation of ownership and control results in a coterie of managers who may make it difficult for owners to control the firm due to an asymmetrical information problem. Furthermore, problems may develop between senior managers and individual risk takers within an organization (such as traders) with the trader driven by incentives to take excessive risks outside the formal control structure of the firm.

Indeed maximizing the return on equity in the interests of shareholders may mean more risk-taking which may not be in the best interests of depositors who have no ability nor incentives to exert discipline over institutions or their (firm's) expectations that the state may provide solvency support.

3.4 The curious case of Cyprus

The case of Cyprus holds valuable lessons for countries in the third world about the need to regularly review the regulatory and supervisory regime to ensure that it is still relevant and appropriate given the international trends.

Financial regulatory and supervisory system in Cyprus

The Cypriot financial regulatory and supervisory system is basically modeled in a similar way as the Zimbabwean model. Consequently, a number of regulatory authorities are involved in the supervision of all financial institutions i.e. Central Bank of Cyprus; Cyprus Securities Exchange Commission; Cooperative Credit Societies Supervision and Development Authority; The Commissioner of Insurance Companies; Insurance Services Law; and finally under the Ministry of Labour and Social Insurance is the Authority for the Supervision of Pension Funds.

Causes of the Cypriot Crisis

The single most important cause of the crisis is the exposure of Cypriot banks to Greece. Poor risk management in two of the largest Cypriot banks to Greek debt was in excess of 25 per cent of the country's GDP. Moreover, contingent liability exposure to Greece amounted to over 140 per cent of Cyprus's GDP (Demetriades, 2012).

Demetriades (2012) argues for an additional market-wide risk management strategy in order to prevent a recurrence of such a huge debt overhang, that is, the establishment of a national credit register listing all borrowers and beneficial owners from both commercial banks and cooperatives to enable them to conduct checks on new loan applications against the register (Table 3 shows financial soundness indicators for Cyprus).

The solution to the crisis has been the levying of a proportion of deposits in excess of USD100 000 up to 60 per cent which was converted into equity.

Lessons for Zimbabwe

The first lesson is that the silo approach to financial sector regulation and supervision allows for threats to stability to fall through the cracks in-between the regulators and supervisors. There is thus a need to switch to a sole supervisor and regulator or twin peaks model. The second lesson is that Zimbabwe needs to also establish a national credit register as in Cyprus. Post-Dollarisation economic growth (MPS, 2012; 2013 and Budget 2012) has been stalled by, inter alias, a high level of Non-Performing Loans (NPL) which have negatively impacted liquidity and capitalization (refer to Table 3).

3.5 Slovenia on the brink

Slovenia is teetering on the brink of a financial crisis due to non-performing loans. The common thread running through Zimbabwe, Cyprus and Slovenia is the silo approach to financial regulation and supervision. With regard to monetary policy all three countries have minimal influence as they have given-up their right to print money. Finally, they are all integrated with the global financial system.

The details are slowly emerging. However, Ambrose Evans-Pritchard of the Telegraph, posited that Slovenia's three largest banks' non-performing loans had reached 20.5 per cent of Gross Domestic Product GDP in 2012 while a third of all corporate debt was non-performing.

Moreover, Slovenia's bank assets stood at 130 per cent of GDP, a drop in the ocean when compared to Cyprus's which stood at 700 per cent of GDP. However, Cyprus's mountain becomes a molehill when compared to Luxembourg's banking assets which stood at 2500 per cent of GDP earning the distinction of being the highest in the Eurozone (IMF, 2011). The major difference, is of course that regulation, oversight and management of financial institutions are more efficient in Luxembourg.

Financial regulatory and supervisory system in Slovenia

The case of Slovenia requires close scrutiny since its financial regulatory and supervisory system is also basically modeled along the Zimbabwean lines. Consequently, a number of regulatory authorities are involved in the supervision of all financial institutions i.e. Bank of Slovenia; Securities Market Agency (ATVP), the insurance regulator (AZN) and the Deposit Guarantee Scheme.

4. HOW EFFECTIVE IS REGULATION AND SUPERVISION IN ZIMBABWE

In order to assess the effectiveness of regulation and supervision in Zimbabwe, we examine the state of three types of regulation: systemic, prudential and conduct of business regulation. To be fair to the Reserve Bank of Zimbabwe, financial sector players have in the past been determined to pull the wool over the Central Bank's eyes by the use of creative accounting, and financial engineering to conceal their large shareholding in the financial institution, and insider loans (self-dealing). Yet, it may also be argued that, the nature of the game requires the Central Bank to be focused and be alert in order to overcome these stratagems. After all consumers are counting on it to do its job to ensure a safe and sound financial system.

4.1 Systemic regulation

Systemic regulation as previously alluded has to do with public policy regulation that is designed to minimize systemic risk i.e. the risk of destruction of the whole financial system or market. Institutions that play a role in mitigating systemic risk comprises deposit insurance (Deposit Protection Corporation) and the lender of last resort (Reserve Bank of Zimbabwe). However, there are two caveats for impact to be achieved. The first is that payout in the event of a bank failure must be large enough compensation to encourage savers to entrust large amounts in their savings account and there should be a mandatory low cost account. The second caveat is that the architectural hierarchy of lender of last resort must be in place. This includes having Treasury bills that will provide the benchmark rate as well as the collateral required to stimulate the interbank market. This is the first level of lender of last resort or the market for bank reserves. Only when this fails does the central bank step in. Alternatively, the banks could open external lines of credit. This requires Zimbabwe banks to be invested in USA treasury bills in order to access offshore interbank markets or the Eurodollar market.

It should be noted that the central bank may also be a source of systemic risk when its objectives for monetary policy are not narrowly focused on price and financial stability particularly when it is not independent. This is the case in Zimbabwe (Nhavira, 2012).

An issue pertaining to systemic risk is that of credit risk. The situation in Cyprus indicates that credit risk can cause serious systemic risk. To this end Cyprus is committed to establishing a central credit register listing all borrowers and beneficial owners from both commercial banks and cooperative banks to enable institutions to check new loan applications against the register (Demetriades, 2012). Closer to home, South Africa established a central credit register as far back as 2007. It is a vital instrument for preventing reckless borrowing and lending. Zimbabwe has no such central register in place.

4.1.1 Deposit Insurance Corporation

The Corporation forms the following functions, keeping the public informed of its role in contributing towards the stability of Zimbabwe's financial system, and the rights of depositors in the event of a contributing institution becoming insolvent and to monitor business activities of contributing institutions. Diamond and Dybvig (1983) contends that deposit insurance also acts like a lender of last resort to stop or prevent bank runs. (We question the veracity of the objective-"enhancing competition"). Its objectives are: protecting depositors, in particular small depositors and contributing towards the stability of Zimbabwe's financial system; and enhancing competition between different sectors and institutions in Zimbabwe's financial system.(It is not clear how it intends to go about enhancing competition. One way, in our view is for them to adopt the Federal Deposit Corporation (USA) approach of publishing comprehensive financial and structural information about every insured institution on its website. This would encourage competition through transparency.

There are two weaknesses with regard to the Corporation's insurance cover. The first is that it protects depositors i.e. all depositors regardless of whether they are individuals or corporations. This weakens the function of the Corporation in attaining its objective of contributing towards the stability of Zimbabwe's financial system. The deposit cover is minimal (USD 150.00 according the website). The result is that consumers or individual depositors are not moved by the deposit insurance cover. It is recommended that deposit cover apply to only individual depositors in the first instance. (This is so because business organizations recruit experts who are capable of identifying weak from strong institutions. In other words the full force of caveat emptor should be brought to bear upon them). In the second instance, where the financial institution's fundamentals are deteriorating, its premiums should be increased. The second weakness is that it lacks skilled personnel with the ability to analyse the returns that are sent to it in such a way that they can verify their authenticity. Recently, The Herald of Friday 28 June 2013 carried an article by the Board's Chief Executive Officer extolling the virtues of deposit insurance. Regrettably, nowhere in that article does he mention the value of the maximum pay out in the event of bank failure!

According to interviews with regulatory authorities (see Appendix 3), they attribute bank failure to "governance issues, non-transparency of operations and non-adherence to rules" and most importantly to a "lack of onsite supervision capacity" it is pertinent to point out that elsewhere in this paper we make the observation that prudential guidelines are not incorporated into legislation in Zimbabwe (Bank Act (Canada) 1991; Banks Act (South Africa), 1990;. They are thus of no legal force or effect and therefore ignored by those who should abide by them.

Furthermore, the consensus was that the Reserve Bank of Zimbabwe (whose staff were seconded to the Deposit Insurance Corporation) was weak in regard to monitoring and surveillance. Doubts were also expressed about whether the

supervision department verifies the correctness of information it receives from the bankers or even whether bank failure forecast is practiced (see Report on Interviewees in Appendix 3).

Securities Commission (SC)

In an unpublished paper for Ministry of Finance, titled Financial Sector Reform 2013, Nhavira, argued that the Securities Act (SA) has been overtaken by events. Firstly, the term securities (its definition) now apply not only to stock exchange traded instruments but embrace all instruments that are traded in a financial market. Therefore the SA should supervise all securities. The second issue is that the Act is trailing global developments in terms of innovation and the way stock exchanges are structured. The SA has a section (insider trading and market abuse) on market conduct which makes it modern in its approach, although it needs enhancing. Upgrading the SA becomes more urgent with the imminent demutualization of the Zimbabwe Stock Exchange thereby changing it from a "club" to a professionally run business venture. He posited further that, there is a number of gaps inherent the Securities Act which require attention as follows:

Self- Regulation

Self- regulation has been employed where the regulator believes it has skills gaps and particularly to supervise issues regarding market conduct. It is therefore appropriate that the SC adopts a self regulation concept as a part of its supervisory regime. The International Council of Securities Associations (ICSA) defines an self-regulatory Organisation (SRO) as a private, non-governmental organization that should be dedicated to the public interest objectives of enhancing market integrity, investor protection, and market efficiency (ICSA, (2006b).

According to Carson (2011) of the World Bank the term SRO sometimes refers to a private organization which performs industry, regulatory or public interest functions under the supervision of a securities regulatory authority, in this case the SC. Furthermore, regulate means: to organize and control an activity or process by making it subject to rules or laws. Consequently a fully fledged SRO performs three main regulatory functions; rule making i.e. establishing rules regulations governing the conduct of member firms and other regulated persons; supervision i.e. supervising members and markets to monitor compliance with rules; and enforcement i.e. enforcing compliance with the rules by investigating potential violations and disciplining individuals and firms that violate them.

SRO's are accountable to their supervisory regulator by law or regulation and through the regulator to government. Supervisory regulators, i.e. SC are responsible for oversight of the operations and governance of the SRO's. SRO's may be used where the market is small with limited government resources (IOSC0 2008:29). The expenses of the SRO are met by the industry as well as through penalties and fines.

Objectives and responsibility of South Africa

South Africa is clear about the responsibility of the regulator. The only discernible shortcoming is that there is no overriding objective (purpose) which becomes the goal to be attained through attaining such objectives as (a) to provide high levels of investor protection; (b) to reduce systemic risk; (c) to promote market integrity and investor confidence (d) to ensure transparency and promotion of investor education. Some bills have the aim of for instance to "increase confidence in the financial markets" or "reduce asymmetrical information" Most significantly, there is no attempt in the South Africa to lay any emphasis on the need to make local financial markets competitive.

The application for an exchange license/ certificate takes the "silo" approach i.e. a particular exchange is licensed to deal in a particular market as opposed to operating in securities. Consequently, the license is granted for an exchange in contrast to South Africa where the license also contains one or more securities referred to in the definition not of "security" as indicated in South Africa but of securities".

Further examination reveals that South Africa does not specify "who" licenses exchanges. It is the practice that there be someone designated as the Registrar. There is a need to designate the Chief Executive Officer or his Deputy as Registrar and Deputy Registrar respectively. This will help participants distinguish his authority or distinguish his powers as Registrar and as Chief Executive Officer.

Independence

The regulator should be operationally independent and accountable in the exercise of its functions. This achieved by making the head and governing board subject to mechanisms intended to protect independence such as procedures for appointment; terms of office, and criteria for removal.

Independence - the regulator should have a stable source of funding sufficient to exercise its powers and responsibilities. Currently, it has four sources (a) levies (b) fees and charges (c) grants from government and (d) any other moneys that may accrue to the Commission (SA, 2008).

It is doubtful that these funds are sufficient to retain experienced staff, to ensure that its staff receives adequate ongoing training, nor reflect the needs of the regulator in supervising the Zimbabwean market where securities firms are integrated into financial conglomerates. The following may be sources of funding (not included in SA): Penalty for failure to furnish information, return etc.; Penalty by any person to enter into agreement with clients; Penalty for failure to redress investor's grievances; Penalty for failure to observe rules and regulations by stock brokers; Penalty for insider trading ; Penalty for non-disclosure of acquisition of shares and take-overs; penalty for fraudulent and unfair-trade practices; and penalty for contravention where no separate penalty has been identified.

As regards whether the regulator has an influence on the allocation of funds, it is not clear from the legislation since it does say what the funds of the commission should be used for. The following additional matters require attention in the SA:

Accountability
The regulator should be publicly accountable in the use of its powers and resources to ensure that the regulator maintains its integrity and credibility. In this regard, the SC is accountable. The regulator is accountable to the legislature or another government body on an ongoing basis. However, there is no legal protection (immunity) for Commission staff acting in the bona fide discharge of their functions and powers.

Transparency
There is no requirement in the SA for the regulator to be transparent in its way of operating and use of resources and to make public its actions that affect users of the market and regulated entities, excluding confidential or commercially sensitive information. Finally, further gaps identified for incorporation are:

Codes of Conduct
The concept of a code of conduct should be incorporated in the SA empowering the SC to prescribe for authorized users, participants or clearing members of independent clearing houses which should be binding on their officers, employees and clients. The code of conduct should ideally be based on clear principles such as: Acting honestly and fairly with due skill, care and diligence and in the interests of a client; Uphold the integrity of the securities service industry. Have and effectively employ the resources, procedures and technological systems for the conduct of its business; Act fairly in a situation of conflicting interests; Disclosure to a client of relevant information, including the disclosure of actual or potential interests

Proper record keeping
Record keeping should adhere to certain principles, such as, avoidance of fraudulent and misleading advertisement, canvassing and marketing, the. Proper safekeeping, separation and protection of funds and transaction documents of clients and\any other matter which are necessary or expedient to be regulated in a code of conduct for the achievement of the goals of the SA. Furthermore, Markets world -wide evolve in a similar fashion particularly when the markets are highly competitive. It is therefore, prudent, subject to the vision for the financial sector to incorporate the effects of these influences now.

Concept of Trade Repositories
The G20 leaders agreed at the 26th September summit in Pittsburgh that all standardized over-the –counter (OTC) derivatives should be cleared through a Central Counterparties (CCP) by end 2012 and that OTC derivatives be reported to trade repositories. Therefore, a trade repository or SWAP Data Repository is an entity that centrally collects and maintains the records of over-the-counter (OTC) derivatives.

Concept of Warehouse Receipt

Nhavira (2013) went on to forcefully argue that Zimbabwe's economy is highly dependent on agriculture. Agriculture is therefore integral to economic development. However, despite its importance to the economy, agriculture (that is rural agriculture) has remained isolated from the mainstream economy. Until now contract farming has been the main plank for removing economic and financial isolation for rural folk. Based on available information, the facilitation of financing agriculture through the use of Warehouse Receipts has not received particular attention. In order to bring this about, there will be a need to evolve a framework for participation of banks in providing loans against Warehouse receipts and eventually a framework for their participation in the commodity futures market.

A Warehouse Receipt is a written document given by a warehouseman for items received for storage in his or her Warehouse which serves as evidence of title to the stored goods. Warehouse Receipts may be non-negotiable or negotiable. These documents are transferred by endorsement and delivery. Either the original depositor or the holder in due course (transferee) can claim the commodities from the warehouse.

There are significant benefits to be derived from Warehouse Receipts as they provide farmers with an instrument that allows them to extend the sales period of modestly perishable goods well beyond the harvesting season. Thus by depositing the goods in a warehouse, the farmer does not need to sell the product immediately to ease cash constraints.

Moreover, Warehouse Receipts may also allow farmers of export commodities to borrow abroad, thereby hedging against the foreign exchange risk of foreign borrowing. However, in order to implement this, there is a need to promulgate a Warehouse law.

In conclusion, there is an urgent need to get Zimbabwe back on par with South Africa in terms of capital market development. The first step is to upgrade the SA. The second step is to adopt a model of self-regulation. This will ensure that foreign investors will be indifferent as to whether they invest in Zimbabwe or South Africa. On a balance of probabilities the decision will favour Zimbabwe because of its stable, highly educated workforce.

4.1.2 Lender of Last Resort

Having dollarized, the Reserve Bank of Zimbabwe is no longer in a position to play a role of lender of last resort (LOLR) because it is unable to create money. It follows therefore that when a central bank has lost its power to create/print money it is not in a position to play that role. This is because the amount of money required to bail out a troubled institution with systemic risk may be open ended. Thus under a dollarized economy, alternative arrangements need to be put in place involving multilateral financial institutions or private arrangements with off-shore private

banks (this is an area for further study). To this end Zimbabwe banks need to invest in US dollar American government Treasury Bills to enable them to access off-shore interbank markets.

Typically the first port of call for a Central Bank to build-up for LOLR is the statutory reserve requirement. This builds up as a result of the competition of the banking system (as lending expands so does the statutory reserves). The second port of call is the interbank market. Only when the interbank market is unable to provide the funds needed do troubled banks approach the central bank. It is therefore important that the interbank market be revived and a reference rate availed at the earliest opportunity.

Table 3 reports the financial soundness indicators for Zimbabwe. The indicators show that Zimbabwe's non-performing loans deteriorated from 1.80 per cent in 2009 to 23.71 in 2012. The return on asset (ROA) improved from 0.01 per cent to 2.43 in 2011 before declining to 1.69 per cent in 2012. This development has a negative impact on cashflow and liquidity. Return on Equity showed a similar trend ending at 9.67 per cent. Zimbabwe lacks a reference rate so there is no benchmark by which we may gauge the viability of this return. Suffice it to observe that the returns are comfortably above the inflation rate.

In as far as liquidity is concerned loans to deposit ratios have escalated from 50.99 per cent in 2009 to 93.35 per cent in 2012 severely hampering availability of liquidity. Clearly the pursuit of profit maximization has caused the banks to disregard prudential lending limits. This does not reflect well on the Central Bank and could be an indication of regulatory capture. Based on experience, a conservative prudent ratio would be one that lies between 50-70 per cent of deposits.

Table 3: Zimbabwe Financial Soundness Indicators 2009- 2012

	2009	2010	2011	2012
CAPITAL ADEQUACY	%	%	%	%
Tier 1 Leverage Ratio	16.73	19.12	8.98	7.02
Tier 1Capital ratio	26.08	22.73	11.24	9.06
Total Capital Adequacy Ratio	27.26	27.34	16.23	19.47
ASSET QUALITY				
NPLs to Total Loans	1.80	5.37	5.89	23.71
Provisions to Total Loans	0.02	2.01	2.95	12.38
Specific Provisions toNPLs	0.36	18.61	26.1	48.11
Share of Mortgage Advances of gross loans and advances	n/a	n/a	n/a	n/a
PROFITABILITY				
Net Income After Tax (% of Gross operating income)	n/a	n/a	n/a	n/a
ROA	0.01	-2.02	2.43	1.69
ROE	0.03	0.57	15.13	9.67
Net interest margin	3.29	5.75	8.21	14.81
Net interest spread				
Cost-to-income ratio	94.38	148.95	185.11	102.54
Interest Income (% of Gross operating income)	n/a	n/a	n/a	n/a
LIQUIDITY				
Cash to Total Assets	41.60	12.54	24.25	10.94
Liquid Assets to Total Assets	0	0	0	0
Loans to Deposits	50.99	86.25	90.59	93.35
Loans to total assets	26.92	44.84	58.25	57.3
Share of Short-term Assets in total deposits	n/a	n/a	n/a	n/a

Source: Reserve Bank of Zimbabwe

4.2 Prudential Regulations

Prudential regulations are mainly concerned with consumer protection. Under the twin-peak model, this falls under the central bank. It envisages the monitoring and supervision of financial institutions with particular attention paid to asset quality and capital adequacy. The Reserve Bank of Zimbabwe undertakes prudential regulation in Zimbabwe and it aims to ensure that the financial institutions under its supervision are financially sound. This includes specifying standards covering risk management and other related requirements. Furthermore, the Central Bank shall be responsible for financial stability (systemic stability) (Bailey, 2010; BOE, 2013; FRRSC, 2013).

Generally, these standards are provided to the Reserve Bank of Zimbabwe by the Bank for International Settlement (BIS). These cover capital adequacy, best practice on asset and liability management and risk management amongst others. However, these prudential regulations in Zimbabwe are in the form of guidelines. Guidelines are by their nature advice which can simply be ignored. This explains why time and time again guidelines on insider loans, are ignored and disguised to appear as something else as experienced at the failed Renaissance and Interfin banks. Furthermore, corporate governance guidelines are also ignored. Section 45 of the Banking Act , on the responsibilities of the Reserve Bank, are silent on prudential guidelines. On the other hand, Banking Regulations, 2000 attempts to incorporate prudential matters, in particular capital adequacy, and credit risk. For instance it cites penalties for non-compliance with regulations as being a fine of Zimbabwe dollar $50,000 (fifty-thousand). This is in an environment where the Zimbabwe dollar no longer exists. Furthermore, although the Banking Regulations, 2000 (section 35) requires that no banking institution shall knowingly extend credit to or for the benefit of or to any person who holds a significant interest or any relative of a person or holder of a significant interest. No penalties are cited in the Banking Act for infringement.

Moreover, the BIS does not recognize prudential guidelines that have not been incorporated into the legislation. As a result only South Africa appears on the BIS website as the only country in Africa (Banks Act (SA) 1990; Banking Act, (Canada) 2000 to name a few) that has fully incorporated Basel II. Most, importantly, is the incorporation in Banking Acts of the requirement that executives and directors act in the best interest of the firm.

The point is that Basel guidelines and best practice standards should be incorporated urgently into banking regulations (http://www.bis.org/fsi/fsipapers04africa.pdf.) and (http://www.bis.org/publ/bcbs/b3prog_dom_impl.htm). The second address contains a list (of links) of all those countries as at 31 December 2012 who had incorporated Basel into their legislation. With this in mind, it is imperative that there be a Standing Committee of financial regulators and Ministry of Finance officials, Ministry of Justice and other interested parties to ensure that regulations are rapidly incorporated into legislation. In the United Kingdom, for instance, the

Financial Services Authority (FSA) was empowered to make regulations in terms of the Financial services and Markets Act 2000, as follows; section 138 (General rule-making power); section 150 (2) (Actions for damages); section 156 (General supplementary powers) and section 157 (1) Guidance whilst section 153 (2) confers upon it the issuance of rule making instruments. This is important in terms of time- consistency (i.e. in constraining management of financial institutions from a tendency to ignore agreed upon goals) as postulated by Kydland and Prescott (1977). Finally, financial institution legislation should expire, or be reviewed every five years.

4.3 Conduct of Business Regulation

Conduct of business regulations focus on how financial institutions conduct their business. This form of regulation relates to information disclosure, fair business practices, competence, honesty and integrity of financial institutions and their employees (Bailey, 2010; BOE, 2013; FRRSC, 2013).

Such regulation does not exist in Zimbabwe. Hence the theme of this paper that there is a need to have a regulator that would take into account conduct of business regulation coupled with a Central Bank that handles prudential regulation which would transform this regulatory model into a twin-peak model.

Lessons from Comparative Statistics

Table 4 compares financial soundness indicators for Zimbabwe, South Africa, Luxembourg, Slovenia and Cyprus. South Africa and Luxembourg as per Table 1 have a strong sound banking system. On the other hand, Cyprus has collapsed into financial crisis while Zimbabwe and Slovenia totter on the brink. What emerges is that those countries on the brink of collapse are evident from the indicators.

Table 4: International Comparative Statistics

	LUXEM-BOURG	SLOVENIA	ZIMBABWE	CYPRUS	SOUTH AFRICA
	2012	2012	2012	2012	2012
CAPITALISATION					
Regulatory capital to risk weighted assets	17.5	12.1	7.02	9.0	15.7
Regulatory tier 1 capital to risk weighted assets	15.0	9.4	9.06		12.6
Capital to assets	6.5			5.6	7.3
ASSET QUALITY					
NPL to total large loans	0.2				
NPL provisions to capital		70.2			
NPL to total gross loans	0.4	13.2	23.71	10.7	4.6
Provisions to NPL	19.3	42.04	48.11	41.3	35.5
Provisions to total loans			12.38	10.7	
PROFITABILITY					
ROA	0.6	0.1	1.69	0.1	1.6
ROE	9.80	0.8	9.67	1.9	21.5
Int margin to gross income	31.0	65.4	14.81		
Noninterest expense to gross income	64.0	39.3	102.54	71.0	
LIQUIDITY					
Liquid assets to total assets	56.0	13.5	10.94		
Liquid assets to short-term liabilities	66.0	40.3	-		
Loan to deposit ratio			93.35	184	

Source: IMF Country Financial System Assessments

In Table 4, the Financial Stability Indicators of interest are compared against two countries which are regarded as fairly strong i.e. Luxembourg and South Africa.

Capitalisation regulatory capital to risk weighted assets

Luxembourg and South Africa are 17.5 and 15.7 per cent respectively Whilst Zimbabwe, Slovenia (tottering on the edge) and Cyprus (which is undergoing a financial crisis) were reported as 7.02, 12.1 and 9.0 per cent respectively. As regards capitalization may be regarded as being on the edge and therefore fragile.

In accordance with Banking Regulations, 2000 Statutory Instrument 205 of 2000, (Capital Adequacy) the Zimbabwe banking sector is classified as undercapitalized at 7.02 (total risk –based capital ratio of more than 6 per cent but less than 10 per cent). However, based on developments elsewhere in the global market place these classifications may require review upward. In fact, Basel III revises the existing global ratios with the intention of creating capital buffers.

Capitalisation regulatory tier 1 capital to risk weighted assets

Luxembourg and South Africa were reported as 15.0 and 12.6 per cent respectively while Zimbabwe, Slovenia and Cyprus stood at 9.06, 9.4 and 5.6 respectively. Once again Zimbabwe's indicator of financial stability reports a borderline case. Under Basel II rules tier 1 capital to risk weighted assets has a minimum requirement of 4 per cent. However, most banks maintain it well above this minimum. Basel III imposes new requirements of a minimum of 7 per cent. As can be seen above in practice prudence demands that banks maintain a minimum of double this level. Zimbabwe is above the minimum set for Basel II and marginally above that for Basel III.

According to Banking Regulations, 2000, the core- capital risk based ratio of 9.06 is classified as adequate as it is higher than 5-8 percent.

Capital to assets ratio (leverage ratio)

Records were not available for Zimbabwe. However, the Banking Regulations, 2000 indicated that a leverage ratio of more than 9 per cent would be classified as well capitalized, that between 6-9 percent as adequate whilst, that between 3-6 per cent would be regarded as undercapitalized.

Non-performing loans (NPL) to total Gross loans

Luxembourg and South Africa reported 0.4 and 4.6 per cent respectively well below the recommended cut-off of 5 percent. In contrast, Zimbabwe, Slovenia and Cyprus reported 23.71, 13.2 and 10.7 per cent respectively. Zimbabwe's NPL figures are way ahead and indicates a fragile state of financial stability as high NPL compromise liquidity of the banking system. Liquidity is a function of the proper management of a bank's assets and loans comprise a large portion of those assets.

Profitability Return on Assets and Return on Equity

The return on assets measures the efficiency of use of the bank's potential, whereas the return on equity measures the rate of return on shareholder investment. Zimbabwe's position appears favourable compared to other countries.

Non-interest expense to Gross Income

Luxembourg and South Africa stood at 64.0 and 31.2 respectively. On the other hand, Zimbabwe, Slovenia, and Cyprus stood at 102.54, 39.3 and 71.0 respectively. In this regard Zimbabwe's non-interest expense exceeds its Gross income. In sharp contrast South Africa appears more efficient than even Luxembourg.

Financial performance

The volatility in performance of the Zimbabwean financial institutions hold important lessons. In this regard they are compared against United States of America banks (this may appear to be a comparison between David and Goliath but is necessary from the perspective that America's financial system is very efficient and can be held up as the image to be attained) in order to determine how they compare- volatile or strong and stable?

The regulator plays a key role in determining the nature of competition and hence performance in their jurisdiction. For instance, the Reserve Bank regards financial returns submitted by institutions as "confidential". This attitude fosters an atmosphere of secrecy which inhibits transparency. On the other hand, the American regulator takes the returns and creates benchmark indicators of performance for the industry and sub-sectors which are freely available to the market and used to whip miscreants into line. We compare the two financial systems to detect gaps in the Zimbabwean financial system as follows:

Table 5: Comparative Performance Zimbabwe vs USA Banks

	Selected Zimbabwean banks				United States of America banks			
	2009	2010	2011	2012	2009	2010	2011	2012
Net Interest Margin	1.30	5.1	5.4	9.3	3.47	3.80	3.63	3.47
Net operating income to avg assets	7.3	50.1	85.1	21.5	-0.11	0.57	0.87	0.95
Return on Assets	-0.3	3.4	3.9	2.3	-0.15	0.60	0.88	1.00
Return on Equity	-1.4	56.6	37.2	21.7	-1.49	5.49	7.81	8.93
% of non-profitable institutions	47.1	14.3	14.3	0	29.10	20.86	15.97	10.97
% of profitable institutions	52.0	85.7	85.7	100	71.9	79.14	84.03	89.21
	2009	2010	2011	2012	2009	2010	2011	2012
Loans to total assets	38.3	41.8	54.5	56.5	54.71	53.88	52.25	52.11
Deposit to liabilities	76.00	77.00	64.00	65.00	55.39	57.66	62.04	65.38
Capital leverage	35	14.1	11.0	7.1	8.45	8.78	9.14	9.22

Source: Zimbabwe Annual financial reports and US data sourced from http://www2.fdic.gov/qbp.

The indicators of interest in Table 5 above are Net interest margin, percentage of unprofitable institutions, loans to total assets, deposits to total liabilities and the capital leverage ratio. Berger and Humphrey (1997) contend that it is important to monitor bank performance in order to separate the good from the bad performers. Furthermore, monitoring bank performance can inform policymakers by assessing the effects of deregulation, mergers and market structures on efficiency.

Bank regulators evaluate banks' liquidity, solvency and performance to enable them to determine when to intervene as well as to gauge the likelihood for problems to emerge (Casu er al, 2006). Bank performance measurement is a crucial tool for improving managerial performance through the identification of the best and worst practices that lead to high and low indicators of efficiency. Therefore banks wishing to improve their performance compare the performance of their peers and evaluate the trend of their financial performance overtime. The central bank's role in this context is to provide such information that facilitates peer comparison.

Net interest margin

At dollarization in 2009, Zimbabwe's net interest margin stood at 1.30 per cent, rose to 5.4 in 2011 and peaked at 9.3 per cent in 2012. In contrast, the USA interest margin was 3.47 in 2009 rose marginally between 2010-2011 and declined to 3.47 in 2012. This reflects the efficiency and competitive nature of banking in the USA. In Zimbabwe, the banking system is oligopolistic in nature with banks tending to cooperate (see Table 6).

Traditionally, managers have aimed at strong and stable net interest margins. These are the determinants of intermediation efficiency and earning performance. USA net interest margins are strong and stable in contrast to Zimbabwe which are volatile and point to a possible switch from traditional banking income i.e. interest to an emphasis on fee income a trend which leads to volatility of earnings and profitability (Greuning et al, 2003). Profitability is the underpinning of a sound banking system- particularly retained earnings. Regulators have a major role to play in ensuring that financial institutions have an appropriate retained earnings policy.

Percentage of unprofitable institutions

In 2009, unprofitable institutions stood at 47.1 percent and 100 percent profitable by 2012. Whilst in the USA unprofitable institutions stood at 29.10 in 2009 declining to 10.97 per cent by 2012. The question is how realistic is the Zimbabwean 2012 statistic of 100 per cent profitability?

Loans to total assets

Loans to total assets ratios rose from 38.3 per cent in 2009 to 56.50 per cent by 2012. In contrast the USA loan to total assets declined from 54.71 in 2009 to 52.11 per cent in 2012. This may be interpreted as a slow-down in lending to improve liquidity. This conclusion is buttressed by the deposits to liabilities ratio. In order for

banks to compensate for expected and unexpected balance sheet changes and to provide funding for growth, liquidity is crucial. This is so because liquidity represents a bank's ability to accommodate the withdrawal of deposits and other liabilities and to fund new loans and investments. Therefore, the importance of liquidity transcends the individual institution and lies at the centre of confidence in the banking system. Shortfalls at one institution can have serious system wide repercussions.

Deposits to total liabilities

The USA position is that deposits increased from 55.39 per cent in 2009 to 65.38 per cent by 2012 thereby confirming that system liquidity was increasing over the period. In the case of Zimbabwe Deposits increased between 2009 and 2010 from 76 to 77 percent respectively and thereafter 2011 and 2012 went into decline i.e. 64 and 65 per cent respectively. This indicated a marginal growth in liquidity as loans were also on an upward trend. Zimbabwean banks tend to have large brick and mortar assets compared to their American counterparties and this is reflected in high ROA as most institutions revalue their assets periodically to boost the capital position. This tends to blur the comparability of the statistics.

Capital leverage ratio

Capital leverage ratio declined from 35 per cent in 2009 to 7.1 percent by 2012 for Zimbabwe banks whilst the USA capital leverage ratio rose from 8.45 in 2009 to 9.22 per cent by 2012. USA banks were more stable than Zimbabwean banks.

HOW COMPETITIVE ARE ZIMBABWEAN BANKS?

As previously alluded to, the regulator plays a key role in ensuring and maintaining competition and innovation in the financial system. To this end the regulator employs such mechanisms as ease of entry, regulations on treatment of consumers of financial services to name a few.

In monopoly power firms have the ability to influence market outcomes especially prices and profit levels, product attributes and innovation (Shepherd,1975). On the other hand, competition is a situation where the market pressure is such that each firm's ability to influence the market is limited. Therefore, a market is described as competitive when the leading firms lack the ability to control it. On the contrary, they are controlled by the market. This can hardly be said to be true of Zimbabwe's six leading banks depicted in Table 7. The regulator's role is to move the market toward perfect competition, as much as possible. Even oligopoly is to be frowned upon as it leads to collusion.

The Herfindahl Hirschman index (HHI) is used to measure the level of competition in an industry. The more concentration an industry has the more monopolistic or less competitive it is. In reality there are shades of competition in between monopoly and perfect competition.

Table 6 indicates that the Zimbabwe banking system had an HH index of 0.20 for 2012 indicating that the industry has a moderate concentration. Competition is necessary to drive the search for efficiency (Neave, 1989) an impetus which is sadly lacking in the Zimbabwe financial sector at this time.

Table 6: Herfindahl Hirschman Index for Banks in Zimbabwe Using Loans and Deposit

Description	2009	2010	2011	2012
Herfindahl Index (loans)	0.20	0.16	0.23	0.23
Herfindahl Index (deposits)	0.14	0.14	0.12	0.20

Source: Own calculation

However, a closer examination reveals that there is one banks which dominate the industry as depicted in Table 7. CBZ, is currently acting as banker to the government, with deposits highly concentrated at 0.64. Since, then there are reports that $650 million dollars has taken flight out of the banking system between January and July 2013. The six institutions listed are the dominant ones in the Zimbabwe financial sector. In this case "concentration creates a presumption of oligopolistic behavior rather than establishing each definitively" (Neaves, 1989).

Table 7: Herfindahl Hirschman Index (Hhi) for Six Major Zimbabwe Banks

Institution	loans	deposits	loans	deposit	loans	deposit	loans	deposit
	2009	**2009**	**2010**	**2010**	**2011**	**2011**	**2012**	**2012**
Barclays	0.001	0.008	0.001	0.008	0.002	0.01	0.002	0.006
CBZ	0.164	0.072	0.099	0.078	0.122	0.64	0.178	0.137
Stanbic	0.003	0.017	0.038	0.022	0.018	0.017	0.006	0.028
Stanchart	0.007	0.029	0.007	0.012	0.003	0.011	0.009	0.012
BancAbc	0.003	0.001	0.006	0.002	0.002	0.003	0.014	0.013
CABS	0.034	0.013	0.015	0.051	0.009	0.007	0.019	0.016
TOTAL	**0.212**	**0.14**	**0.166**	**0.173**	**0.156**	**0.688**	**0.228**	**0.212**

Source: Own calculations based on Annual Financial Reports

Concentration also impacts on bank behavior regarding conduct in the market and strategy as a path to increased profitability. It is characterized by significant spreads in deposit and loans. Customer relationships are focused on punishing them if they leave i.e. transferring bank accounts from one bank to another is not easy. This is illustrated below in Table 7A :

Table 7A: Concentration and Bank Behaviour

Sources of Increased Profits				Bank Behaviour: Conduct	Bank Behaviour: Strategy
	I	Market Structure		Pricing and Availability	Product Differentiation and Network Effects
	II	Switching Costs		Relationship Pricing and Availability	Bank Orientation and Specialization
	III	Location	Distance	Spatial Pricing and Availability	Branching
			Borders	Segmentation	Entry and M&As
	IV	Regulation		Segmentation	Entry and M&As

Source: Adapted from Degryse and Ongena (2005)

As regards the distribution of income in the industry the Gini Coefficient indicates increasing inequality of income as at 2012 with a coefficient of 0.21. from 0.11 and 0.12 respectively for 2011 and 2012.This is consistent with the assertion that there are four dominant banks.

Table 8: Gini Coefficient for Zimbabwe Banks

	2009	2010	2011	2012
Gini Coefficient	0.69	0.11	0.12	0.21

Source: Annual Financial Reports

5. FINANCIAL REGULATIONS AND CHALLENGES IN SUPERVISION

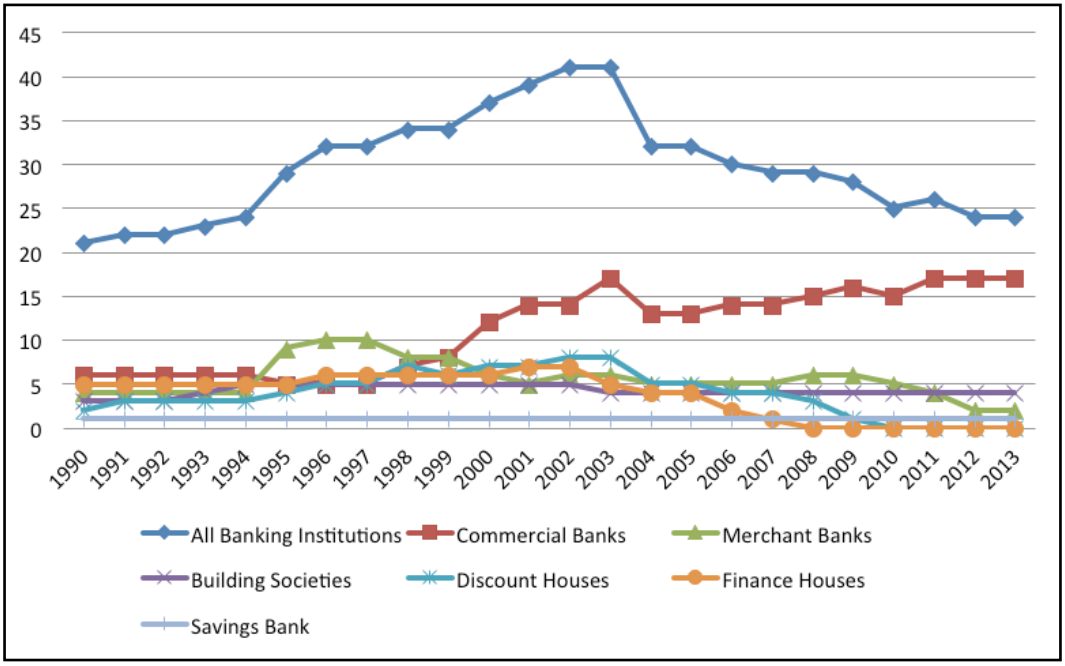
5.1 Introduction

As previously alluded to, the financial sector was relatively stable since independence but experienced instability from the mid-1990s following a period of deregulation and liberalization. However, by 1996, it was clear that Government was not prepared to implement the rest of the reform that was expected and a schism developed with the IMF and World Bank and further support was halted. This was followed by the Democratic Republic of Congo conflict, the unbudgeted payout of pensions to the country's war veterans contributed to the decline of the value of the Zimbabwe dollar. These events were soon followed by the land invasions of 2000 which undermined the economy further as it is highly dependent on agricultural output.

Thereafter, the economy spiraled into deep decline that stretched to 2008. The decline was accelerated and accentuated by the financial regulator's indulgence in quasi-fiscal activities. The country's Gross Domestic Product (GDP) growth rate was -7.4% in 2000 but plummeted to -10.4% in 2003 and it is estimated that the GDP shrunk by 40% between 2000 and 2008 (GoZ, 2010).Whereas, inflation rate was 7 % in 1980; 622% in January 2004; 1281.1% in December 2006 and 231 million % by July 2008 (Mandizvidza: 2011, RBZ: 2012).

The introduction of multiple currency in 2009 brought relief and saw serious economic rebound on the back of strong economic growth averaging 9.5% between 2009-2011 and single digit inflation below 5% (GoZ, 2012). However, since 2011, challenges that faced the financial sector include macroeconomic illiquidity, low savings, volatile deposits and short term loans coupled with the absence of an active inter-bank market and limited access to affordable external credit lines (RBZ, 2013). Figure 1 illustrates the growth and decline of the Zimbabwe financial services sector over the past two decades.

Figure 1: Growth of Banking Institutions in Zimbabwe 1990 - 2013



Source: RBZ Monetary Policy Statements and Supervision Reports

Figure 1 shows that in 1990 before the financial reforms, there were only 21 banking institutions. By 1993, they had increased to 23 and by 2003, they had mushroomed to 41 finally settling at 25 in 2013. Table 9 below lists the number of institutions that have collapsed since 1998.

Table 9: List of Collapsed Zimbabwe Financial Firms 1998-2012

Year	Institution	Cause of collapse
1998	United Merchant Bank	Failure of corporate governance
2002	Universal Merchant Bank	Failure of corporate governance
2002	Zimbabwe Building Society	Failure of corporate governance
2003	First National Building Society	Failure of corporate governance
2004	Rapid Discount House	Failure of corporate governance
2004	Barbican Bank	Failure of corporate governance
2004	Time Bank	Failure of corporate governance
2004	Intermarket Bank	Failure of corporate governance
2006	Royal Bank	Failure of corporate governance
2006	Trust Bank	Failure of corporate governance
2012	Genesis Inv Bank	Failure of corporate governance
2012	Interfin Bank	Failure of corporate governance
2012	Renaissance	Failure of corporate governance
2012	Royal Bank	Failure of corporate governance
2012	Barbican Bank	Failure of corporate governance

Source: RBZ Monetary Policy Statements and Supervision Reports

Signs of distress in the financial sector during the 1990s and early 2000 were evidenced by insolvency of 6 financial institutions (CBZ, Zimbank, ZBS, United Merchant Bank, First National Building Society & Universal Merchant Bank) (Mandizvidza, 2011). The Government responded to the distress by bailing out 3 of the affected banks (CBZ, Zimbank & ZBS).Some legislative reforms were made to address the challenges in the banking sector.For example, the Banking Act and Regulations that came into effect in August 2000 allowed the Reserve Bank of Zimbabwe (RBZ) (Section 45 of the Banking Act) to assume the official role as supervisor of banking institutions (RBZ, 2002). Further, the RBZ, in 2002 further proposed some amendments to the Banking Act (Chapter 24:20) and Banking Regulations of 2000 with the objective of strengthening its supervisory capacity in order to improve effectiveness; expanding the legal framework to allow it to comply with the 25 Core Principles for Effective Supervision, and addressing, as far as possible, areas of ambiguity in the current legislation (RBZ, 2002).

Despite these efforts, the financial sector experienced the worst financial crisis between 2003 and 2006. In fact, nine financial institutions namely Barbican Bank Limited, CFX Bank Limited, CFX Merchant Bank, Intermarket Banking Corporation Limited, Intermarket Building Society, Intermarket Discount House, Royal Bank of Zimbabwe Limited, Time Bank Zimbabwe Limited and Trust Bank Corporation Limited were placed under curatorship (RBZ ,2004). Further, Barbican Asset Management,

Century Discount House and Rapid Discount House were placed under liquidation in the same year (RBZ, 2004). In 2005, First National Building Society was subsequently placed under final liquidation in 2005 after it had been placed under curatorship in 2003. The RBZ established the Zimbabwe Allied Banking Group (ZABG) as an important step in addressing financial stability. With effect from January 2005, the Central Bank adopted a comprehensive Troubled Bank Resolution Framework to effectively deal with problem banks and restore stability of the financial sector. The major objectives of the Troubled Bank Resolution Framework was to strengthen the banking system and promote sound banking practices; develop permanent solutions for troubled banking institutions, and to promote economic development and growth (RBZ,2004).

Further, in 2006 the Central Bank allowed for consolidation of ailing financial institutions through mergers and acquisitions (RBZ, 2006). In addition it recommended that some of the troubled institutions be restructured, liquidated and that depositors be reimbursed of their funds. The RBZ further refined its supervisory approaches in response to the banking sector challenges and introduced risk based supervision; prompt corrective action programmes; consolidated supervision; compulsory credit rating of banks; issuing corporate governance guidelines (Mandizvidza, 2011). All these efforts by the Central Bank were meant to curb financial instability in the economy. The central bank, however, faced serious challenges in implementing these measures. For example two (Trust and Royal bank) of the banks that were forced to amalgamate challenged their amalgamation and successfully appealed to the Ministry of Finance (and the coursts)in order to have their licenses reinstated. However, the fact those depositors could not access their funds for extended period of time from those institutions that had been put under curatorship undermined confidence in some financial institutions. Many depositors ended up questioning the wisdom of placing banks under curatorship and the effectiveness of the Reserve Bank as supervisor.

The recurrence of the unsound institutions continued between 2007 and 2012. These include the cancellation of Barbican Bank's bank licence, the move to place Interfin Bank under curatorship, the liquidation of Genesis Investment Bank and surrender of bank licence by Royal bank after facing serious operating challenges in 2012 (RBZ, 2013). Attendant liquidity shortages coupled with the absence of an active inter-bank market, limited access to affordable external credit lines and absence of Lender of Last Resort compounded the domestic operating environment for banks. challenges faced by Royal Bank and Genesis Investment Bank. Admittedly, underlying risks associated with adverse macroeconomic developments and mismanagement at some banks provided fertile ground for potential liquidity challenges and capital insolvency

Several factors explain why the financial sector went into such a crisis. These include first the unstable macroeconomic environment alluded to above. Second, the Financial sector indiscipline where the banking institutions would divert from their

core businesses to speculative activities such as purchase of bricks, cars, real estate, shares etc (RBZ :2009, Mandizvidza:2011). Third was the gross laxity by the Central Bank to provide prudential supervision and inadequate risk management systems. Inadequate regulatory framework for the non-bank financial institutions such as the Zimbabwe Stock Exchange, Stock Brokers, Insurance Companies and Pension Funds significantly compromised the financial stability of the economy (RBZ, 2009). Fourth was the non performance of insider loans among other factors. Some of the financial institutions had poor corporate governance structures marred with poor board oversight and dominated by a few shareholders (Mandizvidza, 2011). The case of financial irregularities at Renaissance Merchant Bank (RMB) seem to reveal the weakness in the supervisory role of oversight authorities in that two shareowners owned about 70% of the bank against the central bank guidelines that stipulate that no single shareowner can own more than 10% (Mhlanga, 2011). Another reason that may have contributed to collapse of the banking institutions was the unprecedented increase in overnight central bank accommodation rates from 300 per cent to 500 per cent and for secured lending and from 350 to 600 per cent for unsecured lending in October 2006 bearing in mind that the increase occurred after financial institutions had been granted accommodation. This sealed the collapse of those institutions. (RBZ,2006). Moreover, this had the effect of increasing general interest rates in the economy, making it more expensive for the borrowing public and undermined the soundness of the financial sector.

The period 2000-2008 brought the role of the Reserve Bank of Zimbabwe in the economy and the financial sector under closer scrutiny. It appeared that there was no coordination between monetary policy and the financial stability of the economy and banking supervision. In other, words systemic stability was an issue that appeared not to be uppermost in the minds of the authorities at the central bank. The soundness of the financial sector became questionable in particular the length of time it takes the central bank to detect anomalies and to resolve such challenges. As a result the central bank became well-known for reversing its policies. This time consistency problem highlighted the challenges that the central bank faced in supervising the financial system.

In Zimbabwe, a major challenge for regulators, supervisors and the supervised alike is the absence of a guiding vision of the future of the financial services sector. Thus leaving it adrift rudderless. Since the adoption of the structural adjustment programme in 1991, the challenges to bank supervision have multiplied with the liberalization and deregulation of the financial sector. The number of banks has swelled from 6 in 1991 to 25 by 2013. However, the increase in banks has not been matched by an equivalent increase in the supply of skilled staff. A scarcity of qualified and experienced professionals was compounded by the emigration to the diaspora of such staff during the financial crisis years of 2000-2008. There is evidence from MEFMI that personnel from the supervision department go out on training missions in the region. It is however, a fact that it has not escaped unscathed the attrition of staff that occurred between 2000-2008. Many institutions were forced

to employ and promote individuals who may not have possessed the requisite managerial experience. Such institutions are more prone to run into problems since management of bank risks requires sound judgment and good organizational skills especially in the increasing competitive environment. Furthermore, the lack of experienced staff could easily lead to poor internal controls, frauds and bad loan procedures placing the affected institution in jeopardy.

A further source of challenge was the rapidly unfolding events post-dollarisation. Due to lack of a vision or policy, the central bank was unable to provide a solution for the way forward for financial institutions that entered the dollarized era virtually insolvent. They therefore, engaged in levying high bank charges, high interest rates and tied- cross selling (i.e. selling own insurance products such as funeral policies, life cover, credit cover some which was unsolicited by clients.

5.2 Conglomeration

Conglomeration, on the one hand has brought with it new powers which foster greater flexibility, efficiency and profitability whilst on the other hand, it leads banks into unfamiliar terrain which in turn exposes them to a variety of new risks. Considering the shortage of skilled personnel, such a development raises serious doubts about the ability of banks to reasonably manage such risks.

The introduction of deposit insurance, though promoting depositor confidence and the prevention of bank runs, has the potential to significantly alter the attitude of banks towards risk. It is the subsidy aspect of deposit insurance which contains a "moral hazard" whereby banks assume higher risks knowing well that depositors no longer have the incentive to monitor them. The moral hazard is accentuated where authorities show reluctance in liquidating insolvent institutions.

5.3 Macroprudential approach

A silo-based approach as currently exists (multiple regulators/supervisors depending on institution) in Zimbabwe encourages a blinkered approach to regulation and supervision. Reserve Bank of Zimbabwe, has attempted to downplay this by entering into Memorandum of Understanding with other regulators and introducing consolidated supervision). However, all these are attempts to create overcome weaknesses in the silo approach and still fall short of the optimal regulatory and supervisory structure. Recently, Zimbabwe has introduced a systemic stability committee in an attempt to implement the macroprudential approach. This approach has been found to work best when it is accompanied by specialization in prudential regulation and market (financial conduct) conduction regulation and supervisory structure. However, implementation of the macroprudential approach includes, inter alias, as earlier indicated the issuing of a periodic report on the stability of the financial system. The current committee is yet to produce such a report. Under the circumstances, such a committee should be properly constituted under legislative mandate with clear powers and accountability.

The global financial crisis of 2007-2009 has renewed interest in a macro prudential approach to regulation which involves the analysis of macroeconomic trends and how they impact prudential soundness and the stability of financial firms and the financial system. Moreover, the enormous costs of the crisis has forced governments across the globe to reconsider how they approach financial sector regulation. Zimbabwe should not be the exception.

The macroprudential approach attempts to identify and control risks from linkages between financial institutions. This is based on the rationale that where one financial institution has large exposures to another then ill health of one will affect the health of the other. On the other hand actions designed to boost the health of one entity might have unanticipated and adverse consequences on the other. Zimbabwe is a case in point. The regulator turned a blind eye to the antics of the banking sector to recapitalize through levying high bank charges. The unintended consequence was that confidence by the public in the banking system was undermined. Another blind eye was turned on the excessively high lending rates of 2009 which had the unanticipated adverse effect of undermining the viability of commerce and industry. Below is a table that contrasts macroprudential and microprudential approach which is self-explanatory. Zimbabwe has adopted the Common Market for East and Southern Africa (COMESA) approach.

Table 10: The Macro and Microprudential Perspectives Compared

	Macroprudential	Microprudential
Proximate objective	limit financial system-wide distress	limit distress of individual institutions
Ultimate objective	avoid output (GDP) costs	consumer (investor/depositor) protection
Characterisation of risk	Seen as dependent on collective behaviour ("endogenous")	Seen as independent of individual agents' behaviour ("exogenous")
Correlations and common exposures across institutions	important	irrelevant
Calibration of prudential controls	in terms of system-wide risk; top-down	in terms of risks of individual institutions; bottom-up

Source: Borio (2003)

5.4 Lessons

There are lessons to be learned by Zimbabwe from the global financial crisis: The first lesson is the need for adoption of a macroprudential approach towards supervision as opposed to a purely microprudential one. The second lesson is the loss of credibility of self-regulation through improved risk management practices. There is still a need for regulators to monitor changes in systemic risk. Hence the adoption of the macroprudential approaches to supervision. The third lesson is that whereas the global financial crisis has proven the paucity of a policy that forces banks to lend to consumers who cannot afford to repay their loans. There is thus a need to strike a balance between socio-economic objectives with the imperative of financial stability. Therefore, the regulation of market conduct must be directed to eliminating lending and banking malpractices, such as excessively high bank charges, excessively high lending rates and a lack of deposit rates. The goal of market conduct regulation is to protect consumers and reduce systemic risk of the financial system. The fourth lesson is that prevention of macroeconomic imbalances through cooperation amongst the global community to address the issue of imbalances between savings and consumption which led to the financial crisis.

5.5 Globalisation

The standardization of the global financial system through the efforts of the Bank for International Settlements (BIS) through its pronouncements such as Basel I, II and now III has been a major challenge to implement for Zimbabwe for a variety of reasons. The first is the inability of the regulator to have them converted into law. Secondly, the regulator has been efficient in churning them out in the form of Prudential Guidelines. In consequence, management of institutions have regularly ignored them. Thirdly, is the inability of the regulator to implement them as envisaged by the BIS and within the required time-frame. Currently, the financial sector is trying to implement Basel II.

5.6 Derivative products

A further challenge is that of derivative products that are traded over the counter (OTC). It is now a requirement, internationally, that these be reported. Being securities should they be reported to the SEC or to the central bank? Issues such as these can best be resolved in a rationalized reporting structure that takes cognizance of the fact that financial markets have evolved and that the functional approach may not be the most efficient way of organizing regulatory matters and their supervision. With the foregoing in mind, the urgency for reshaping supervisory capabilities and regulations in line with ongoing evolution of the financial system becomes clearer. It is our considered opinion that delays may prove costly

6 CONCLUSION AND POLICY RECOMMENDATIONS

6.1 Introduction

The purpose of this study was to determine whether the regulatory and supervisory regime of the financial system in Zimbabwe is still relevant for Zimbabwe at this time. Particularly in the absence of a guiding vision for the financial services sector and against which the financial services sector can be measured against periodically, thus far, The evidence points to the fact that the regulatory and supervisory system is no longer relevant for Zimbabwe as indicated by: bank failures and loss of public confidence in the system. The cause of this failure is partly, in the majority of instances a shareholder obtaining or awarding himself or related parties loans which eventually sink the bank due to non-performing. There is also very robust creative accounting and window dressing. Some argue that the Central Bank is not discharging its duty due to being financially crippled and lacking legal muscle. That is precisely, what this paper is arguing. That the Central Bank as it is currently structured has not staved off financial crises and bank failures. It is therefore imperative that the legal muscle be given to it through splitting it into two regulators. The first looks after the banks as before and the other looks after how financial institutions interface with consumers! However, most significantly is the lack of a vision as to what the financial system should evolve into.

Most significantly, the financial system has changed through innovations as managers seek to maximize profits through conglomeration. In light of the conglomeration of the financial system and in order to address shortcomings in the regulatory structure, it is imperative that careful thought be addressed as to the way forward for the financial sector.

The pursuit of a twin-peak model for Zimbabwe is justified in that The World Economic Forum ranked Zimbabwe 109 on financial market development ahead of Slovenia and Greece which were ranked 128 and 132 respectively. Zimbabwean markets are well developed. They lack the necessary legislation and regulator to take care of consumer issues that affect confidence in those markets. Furthermore, securities markets are no longer in a silo but transcend right across the financial system. It makes sense that the entire system be regulated as one unified whole instead of piece-meal as is currently the situation. If Zimbabwe is serious about leveraging the financial system and attracting foreign direct investment, then there is a need to put prepare now for the coming prosperity. Moreover, Greece and Cyprus's financial system collapsed because they had multiple regulators and had not adopted the macroprudential approach that comes with it.

A further justification for twin-peak adoption is that South Africa, the engine of growth for Sub-Saharan Africa has adopted this model and is in the process of implementation. It is in our own best interest to integrate our financial system with theirs in order to leave little choice between investing in Zimbabwe or South Africa. In any event labour in Zimbabwe is more stable and highly skilled. A guiding vision

helps to clarify decision-making when everyone is clear about where they are heading.

The looming integration of Southern Africa Development Community countries is immiment giving further impetus for Zimbabwe to adopt a model that will enable the financial system to weather any financial crisis whether global or local.

6.2 Prudential Regulator

Under this arrangement, the Reserve Bank is to be responsible for prudential regulation and oversee the financial stability of the financial system (systemic risk). As regard the Deposit Protection Board, there is a need to make it more focused i.e. to protect individual depositors only and not firms. Furthermore, make the amount significant.

Since the Bank will have a mandate to oversee systemic risks that may emerge from key financial markets infrastructure. The Bank may have an entity under it headed by a deputy governor and accountable to the Reserve Bank of Zimbabwe.

Bank supervision division is highly regarded in the region (MEFMI). However, it would appear there may be some political influence at play in some decisions. It is therefore, imperative that the central bank be made politically independent.

6.3 Market Conduct Regulator

It is recommended that a new body to be established to be called the Financial Services Authority with responsibility for market conduct (see Figure 2 below). It is envisaged that this entity would emerge from a transformed SEC and IPEC. Like the Prudential regulator, it will have a range of supervisory tools at its disposal such as scheduled and ad hoc on site-visits, reviewing compliance and other reports including "mystery shopper" technique (which uses anonymous independent observers posing as customers).Furthermore, the regulator will be empowered to intervene to mitigate any emerging market conduct risks both at an industry and institutional level. This agency would in the first instance supervise financial institutions to ensure compliance with consumer provisions as they apply to them; secondly, canvass the implementation of policies and procedures designed to protect financial service consumers; thirdly, monitor how voluntary codes of conduct protect interests of consumers; fourthly, ensure that consumers are educated about financial institution's obligations to them(consumers have in the past been missold products such as funeral policies, credit insurance related products, and charged usurious interest rates and fees).

With regard to the issue of licencing exchanges both regulators will be jointly responsible. In this regard, the market conduct regulator will be legally required to consult with the Reserve Bank of Zimbabwe (Prudential regulator) on relevant matters.

On the other hand, as systemic regulator the Bank will be entitled to access information from the relevant exchange. Moreover, the prudential rules applicable that are applicable to members of the exchange will also be subject to the approval of the Bank. In the event that Securities legislation incorporates clearing house licences and rules would be a joint responsibility (FRRSC).

Finally, measures to improve access to financial services regardless of income and the introduction of a standard low cost account and a process to govern bank closures.

6.3.1 Standing Committee of Financial Regulators

For administrative reasons, we recommend the establishment of a Standing Committee of financial regulators which is in line with international trends. Its purpose will be to ensure overall coordination of financial regulation and serve as a formal channel for resolving conflicts. Furthermore, it will coordinate efforts to maintain financial stability as well as play an advisory role in the event of a crisis and its management and resolution. Its members will include officials from the Ministry of Finance (M.O.F.), Market Conduct Regulator (MCR) and stakeholders such as the Bankers Association of Zimbabwe (BAZ), Insurance Association and the Ministry of Justice (MOJ) officials. It would be chaired by the Ministry of Finance.

6.3.2 Standing Committee on Financial Stability

There will also be a need to continue the current financial stability committee which is chaired by the Governor of the Reserve Bank of Zimbabwe. It will comprise the RBZ, MOF, and MCR.

6.3.3 National Credit Register

It is apparent from the financial soundness indicators that liquidity problems emanating from non-performing loans as a major precursor to a financial crisis. Accordingly it is recommended that Zimbabwe introduce a national credit register and accompanying legislation to pre-empt credit risks.

6.3.4 Guidelines or laws

BIS prudential guidelines such as Basel I, II and III should be incorporated into the relevant legislation as soon as they are received and after consultation with the market. This process should proceed more smoothly once the prudential regulator is in place.

6.3.5 Corporate Governance

Despite the Reserve Bank's spirited effort to curb corporate governance failure, it has not been successful. It is therefore recommended that corporate governance would be greatly improved by amending the Banking Act 2000 and the Companies Act to confer on directors and officers, a duty of care i.e. that they should act honestly and in good faith with a view to the best interests of the bank (firm); and to exercise the care, diligence and skill that is expected from a reasonably prudent person acting under similar circumstances (Bank Act, 1991).

6.3.6 Bank Capitalisation

Increasing the capital of all banks equally, is not in our opinion, the best approach. Accordingly it is recommended that in order to allow for new entrants and for increasing competition that there be promulgated a" widely held rule " which would imply that no more than 10 percent of any class of share in a bank may be owned by a single shareholder, or by shareholders acting together. In the case of a widely held bank, an investor may be permitted to to hold up to 20 per cent of any class of voting shares and up to 30 per cent of non-voting shares subject to a "fit and proper test." Accordingly, there should ideally be three classes of bank or financial institution:

Table 11: Ownership Structures of Zimbabwe Banks

Ownership structure of Zimbabwe Banks			
Bank Classification	Equity	Ownership type	Ownership Restrictions
Small Banks	Less than $15million	Closely held	No ownership restrictions
Medium Banks	Between $15 million and $50million	Closely held	65 per cent of shares closely held and 35 per cent publicly traded
Large Banks	Greater than $50 million	Widely held	20 per cent voting shares and 30 per cent non-voting

Source: Adapted from Canadian Bank Act (1991)

6.3.7 Lender of last resort

The economy has been plagued by liquidity crises in which the Reserve Bank has not been able to play a role. Liquidity may be increased by allowing more foreign banks to enter by offering services to businesses and individual consumers through branches, in addition to subsidiaries. As previously alluded to the question of LOLR under dollarization is, best addressed, as an area for further study.

7. EMERGING POLICY OPTIONS FOR POLICYMAKERS

The evidence points towards a need for reform as a result of new challenges that have emerged as a result of the evolution of capital markets and financial services through innovations brought about by technology, globalization and conglomeration. Clearly, the Zimbabwe regulatory structure is not optimal for promoting a competitive financial services sector and supporting continued financial and economic innovation emanating locally, regionally and abroad.

However, prior to examining the options, the policymaker must seriously consider: the question of having a guiding vision of the financial services sector in Zimbabwe along the following lines suggested by Nhavira (2012) which is in keeping with Quintyn and Taylor(2007) who argued that there should be a strategy to facilitate the design of a regulatory and supervisory regime:

The long-term guiding vision is the development of a sound market based (competitive, integrated and efficient) financial system that supports: mobilization, efficient financial resource allocation and broad based sustainable economic development.

The vision encompasses the following:
It is now well recognized that a diversified competitive but prudentially sound financial system plays a very important role in the development process by ensuring efficient accumulation and effective allocation of financial resources. By developing the Zimbabwean financial system, it will improve the process of bringing savers and investors together with those needing finance more efficiently, thereby ultimately enhancing growth and employment creation and poverty alleviation.

Having established the vision, then consider and decide amongst the following options as to the way forward:

7.1 Option one
This option calls for policymakers to do nothing.

7.2 Option two
The second option is to attend to the weaknesses identified in the various pieces of legislation such as the Deposit Protection Board, the Reserve Bank of Zimbabwe Act, the Banking Act 2000 and most importantly, urgently incorporating prudential regulations and guidelines (Basel II and III) into the Banking Act.

7.3 Option three
This option calls for implementing option two and implementing the Integrated Approach. This would mean that Zimbabwe would be travelling up the regulatory evolution curve. Quintyn and Taylor (2007) recommend the integrated approach

for Sub-Saharan Africa. However, in a post 2007-2009 financial crisis the twin-peaks model is highly recommended.

7.4 Option four

This option calls for implementing option two, then option three- the Integrated Approach and in the long-term implementing the twin peak model.

7.5 Option five

Option five is an option that takes the view that the integrated approach is a stepping stone to twin peaks model. The pioneers were not aware of this destination because they were feeling their way and making incremental decisions and managing risk as they ventured into the unknown. However, why reinvent the wheel? (See Appendix 1) Therefore option five is the option that entails implementing option two and then working directly to implement the Twin Peaks model (See Appendix 1). Twin peaks model was also highly recommended by Quintyn and Taylor (2007) as appropriate for Sub-Saharan Africa. Capacity constraint issues are best resolved by amalgamating the various multiple regulators and resources thereby minimizing duplications Quintyn and Taylor (2007).

8 FURTHER AREAS OF RESEARCH

The future areas of research include implementation of the twin peaks approach, and regulatory gaps that need filling in Zimbabwe's financial Regulatory and Supervisory system.

REFERENCES

Annual Financial Reports

Bailey, S (2010): "Super Regulator" Chartered Accountants Journal December 31-33

Bank Act (1990): Government of South Africa

Bank Act (1991): Government of Canada

Bank Act (2000): Government of Zimbabwe

Barth, JR Gerard, Caprio, R., and Levine, R (2001): Do Regulation and Ownership Affect Performance and Stability? In: Prudential Supervision: What Works and What Doesn't. (eds.) Mishkin, F.S. University of Chicago Press. p31-96.

Berger, AN and Humphrey, DB (1997): "Efficiency of Financial Institutions: International Survey and Directions for Future Research", European Journal of Operational Research Vol. 98 175-212.

BIS(1996, 2010) Basel II and Basel II Bank for International Settlements Basel, Switzerland.

BIS (2004) The Implementation of the new capital adequacy framework in Africa summary of responses to Basel II implementation assistance questionnaire available from (http://www.bis.org/fsi/fsipapers04africa.pdf.)

BOE (1998): "Consolidated Supervision of Banks". Handbooks in Central Banking No.15 Bank of England, London. Available from: http://www.bankofengland.co.uk/education/Documents/ccbs/handbooks/pdf/ccbshb15.pdf

BOE (2013): The Prudential Regulation Authority's Approach to Banking Supervision, Bank of England Prudential Regulation Authority, April.

Borio, C (2003): Towards a Macroprudential Framework for Financial Supervision and Regulation BIS Working Paper 128

Botha, E and Makina, D (2011): "Financial Regulation and Supervision: Theory and Practice in South Africa", International Business and Economic Research Journal 10 (11) 27-36

Government of Zimbabwe (2011) The 2012 National Budget Statement, Ministry of Finance, Harare ?
(http://www.bis.org/publ/bcbs/b3prog_dom_impl.htm)

Carson, J (2011): "Self-Regulation in Securities Markets" The World Bank, Securities Working Group, January.

Casu, B, Molyneux, P and Girardone, C (2006): Introduction to Banking, Prentice Hall/Financial Times, London.

Collective Investment Schemes Act [Chapter 24:19] (Act No. 25 of 1997)

Croley, SP (1998): "Theories of Regulation: Incorporating the Administrative Process" Columbia Law Review 98 (1)

Degryse, H and S Ongena (2005): Distance Lending Relationships and Competition, Journal of Finance 60 (1) 231-266.

Demetriades, P (2012): "Cyprus Financial Crisis: the framework for an economic recovery within the eurozone." Speech by Panicos Demetriades, Governor of the Central Bank of Cyprus, at a discussion organized by the Hellenic American Bankers Association and the Cyprus-US Chamber of Commerce New York, 11 December.

Deposit Corporation Act (2011) Government of Zimbabwe

Diamond DW and Dybvig, PH (1983) "Bank Runs, Deposit Insurance, and Liquidity" Journal of Political Economy vol 91 (3) 300-315.

Finmark Survey, 2012. http://www.finmark.org.za/blog/in-the-media/finscope-msme-survey-zimbabwe-2012/

Fleming, A and Taylor, M (1999.) Integrated Financial Supervision: Lessons from Northern European Experience. The World Bank. http://World bank.org/doi/book/10.1596/1813-9450-2223.

FSSA Country reports (various): International Monetary Fund Financial sector Assessment Program. Available from FSAP0https://www.imf.org/external/np/fsap/fssa.aspx

FRRSC (2013): "Implementing a twin peaks model of financial regulation in South Africa" Published for public comment by the Financial Regulatory Reform Steering Committee.

G30, (2008): "The structure of Financial Supervision: Approaches and Challenges in a Global Marketplace" Group of Thirty Consultative Group on International Economic and Monetary Affairs, Inc Available at http://www.group30.org/pubs/pub_1428.htm.

Greuning, H and Bratanovic, SB (2003): Analyzing and Managing Banking Risk The World Bank Washington D.C.

Goodhart, C and Schoenmaker, D. (1995): Should the Functions of Monetary Policy and Banking Supervision be Separated? Oxford Economic Papers, 47 (4): 539-60.

Goodhart, CAE (2000): "The Organisational Structure of Banking Supervision" Financial Stability Institute FSI Occassional Paper Series No.1. Financial Stability Institute Bank for International Settlements, Basel, Switzerland.

Goodhart, CAE (2011): Basel Committee on Banking Supervision: The History of the Early Years 1974-1997. Cambridge: Cambridge University Press. 624pp.

Government of Zimbabwe (2000) Financial Services and Markets Act 2000, Harare, Government Printers

Government of Zimbabwe (2010) Millennium Development Goals Status Report, Zimbabwe, UNDP, Harare

Government of Zimbabwe (2012) The 2013 National Budget Statement, Ministry of Finance, Harare

Herring, R.J. and Carmassi, J. (2008): The structure of Cross-Sector Financial Supervision: Financial Markets, Institutions and Instruments, 17 (1):51-76.

(http://www.bis.org/fsi/fsipapers04africa.pdf.)

http://www.consultancyafrica.com/index.php?option=com_content&view=article&id=810:bank-regulation-and-supervision-a-case-of-institutional-weakness-and-regulatory-capture-in-zimbabwe&catid=87:african-finance-a-economy&Itemid=294

ICSA (2006b): "Self-Regulation in Financial Markets" http://www.icsa.bz/pdf/icsaSelf-regulationinfinancialmarkets.pdf International Council of Securities Association.

1MF (2011) Financial Stability Assessments- Slovenia, Luxembourg, South Africa. International Monetary Policy.

IOSCO (2008). "Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation" http://www.iosco.org/library/pubdocs/pdf/IOSCOPD266.pdf.

IPEC (2012) Annual Reports Insurance Pension Commission

IPEC (2000; 2004) Annual Reports Insurance Pension Commission

Kydland, FE and EC Prescott (1977) "Rules Rather than Discretion: The inconsistency of Optimal plans" The Journal of Political Economy 85 (3) 473-492

Llewellyn, DT (2005): "Institutional Structure of Financial Regulation and Supervision: the Basic Issues", In: Fleming A., Llewellyn DT and Carmichael J (Eds.), Aligning Financial Supervision Structures with Country Needs, World Bank Publications, Washington D.C. 19-85.

Mhlanga, G. (2011) Bank regulation and supervision: A case of institutional weakness and regulatory capture in Zimbabwe

Mandizvidza W. (2011) International Association of Deposit Insurers Resolution of Problem Banks: Purchase and Assumption Option, http://ndic.org.ng/files/P&A%20Transaction%20Process%20-%20Legal%20Authorisation%20And%20Other%20Legal%20Issues%20-%20Taribo.pdf

Martinez, J.and Rose, TA (2003): "International Survey of Integrated Financial Sector Supervision, World Bank Policy Research Working Paper no. 3096 World Bank: Washington.

Martinez, JDL (2010) "Consolidated Supervision" US Federal Reserve/ World Bank/IMF Seminar for Senior Bank Supervisors Washington, DC, October 18-19, 2010. Available from: http://www.siteresources.worldbank.org/Extfinancialsector/resources.

Masciandaro, D and Quintyn, M (2009): "Reforming Financial Supervision and the Role of Central Banks: a Review of Global Trends, Causes and Effects (1998-2008) Centre for Economic Policy Research Policy Insight No. 30 1-11.

Masciandaro, D and Quintyn, M (2010): Regulating the Regulators: The Changing face of Financial Supervision Architectures before and after the Crisis IMF Washington D.C.
http://www.dev3.cepr.org/meets/wkcn/1/1724/papers/masciandarofinal.pdf

Minsky, H (2008): Stabilizing an Unstable Economy New York: McGraw-Hill

National Treasury Policy Document (2011): A safer Financial Sector to Serve South Africa Better Department of National Treasury, South Africa.

Neave, EH (1989): Canada's Approach to Financial Regulation" Canadian Public Policy/Analyse de Politiques, Vol. 15 (1) 1-11

Nhavira, JD and Pindiriri, C. (2011): "Sub-Saharan time-Consistency: A comparison of SADC and the RBZ Law" , Journal of Strategic Studies 2(1): 63-87

Neave, EH (1989): Canada's Approach to Financial Regulation" Canadian Public Policy/Analyse de Politiques, Vol. 15 (1) 1-11.

Nhavira, JDG (2012): Did the Reserve Bank of Zimbabwe Charter Contribute to Hyperinflation: A Critical Review." Journal of Strategic Studies (1) 9-50.

Nhavira JDG (2012) : "Financial Sector Reform 2012" an unpublished paper written for the Ministry of Finance, Zimbabwe.

Nhavira JDG (2013b): Securities Market Policy Brief an unpublished paper written for Ministry of Finance Zimbabwe.

Quintyn, M and Taylor, MW (2007): "Building Supervisory Structures in Sub-Saharan Africa-An Analytical Framework" International Monetary Fund IMF Working Paper WP/07/18

RBZ (2010, 2011, 2012): Monetary Policy Statements, Reserve Bank of Zimbabwe.

RBZ Act (2010): Reserve Bank of Zimbabwe Act, Government of Zimbabwe

RBZ (2000) Banking Supervision Annual Report, http://www.rbz.co.zw/bsannual/2000c.asp

RBZ (2005) Monetary policy statement THE FOURTH QUARTER TO 31 DECEMBER, 2004
RBZ (2002) Banking Supervision Activities in the Year 2002, Annual Report, http://www.rbz.co.zw/annual/activities.asp

RBZ (2004) Annual Report, http://www.rbz.co.zw/annual/2005/pdf/annual11.pdf

RBZ (2006) Bank Licensing, Supervision & Surveillance Annual Report www.rbz.co.zw

RBZ (2009) Monetary Policy Statement: Turning Our Difficulties Into Opportunities. "Exports, Forex, Exports", January 2009, Reserve Bank of Zimbabwe, Harare.

RBZ (2012) 2012 Mid-Term Monetary Policy Statement, http://www.rbz.co.zw/pdfs/2012%20MPS/Mid%20Term%20MPS%20July%202012.pdf

RBZ (2013) Monetary Policy Statement, January 2013, Reserve Bank of Zimbabwe, Harare.

Reddy, Y (2001): "Issues in Choosing between Single and Multiple Regulators of Financial System," Speech delivered at the Public Policy Workshop, ICRIER, New Delhi, 22 May.

Securities Act (2008): Government of Zimbabwe.

Shepherd, WG (1975): The Treatment of Market Power, New York Columbia University Press.

SI (2000): Statutory Instrument 205 of 2000, Government of Zimbabwe.

Siregar, RY and James, WE (2006):" Designing an Integrated Financial Supervision Agency: Selected Lessons and Challenges for Indonesia" ASEAN Economic Bulletin 23 (1).

Taylor, M and Fleming, A (1999): "Integrated Financial Supervision, Lessons from Northern European Experience", Policy Research Working Paper, 2223, The World Bank.

USA (2009-2012): Financial Annual Reports. http://www2.fdic.gov./qbp.

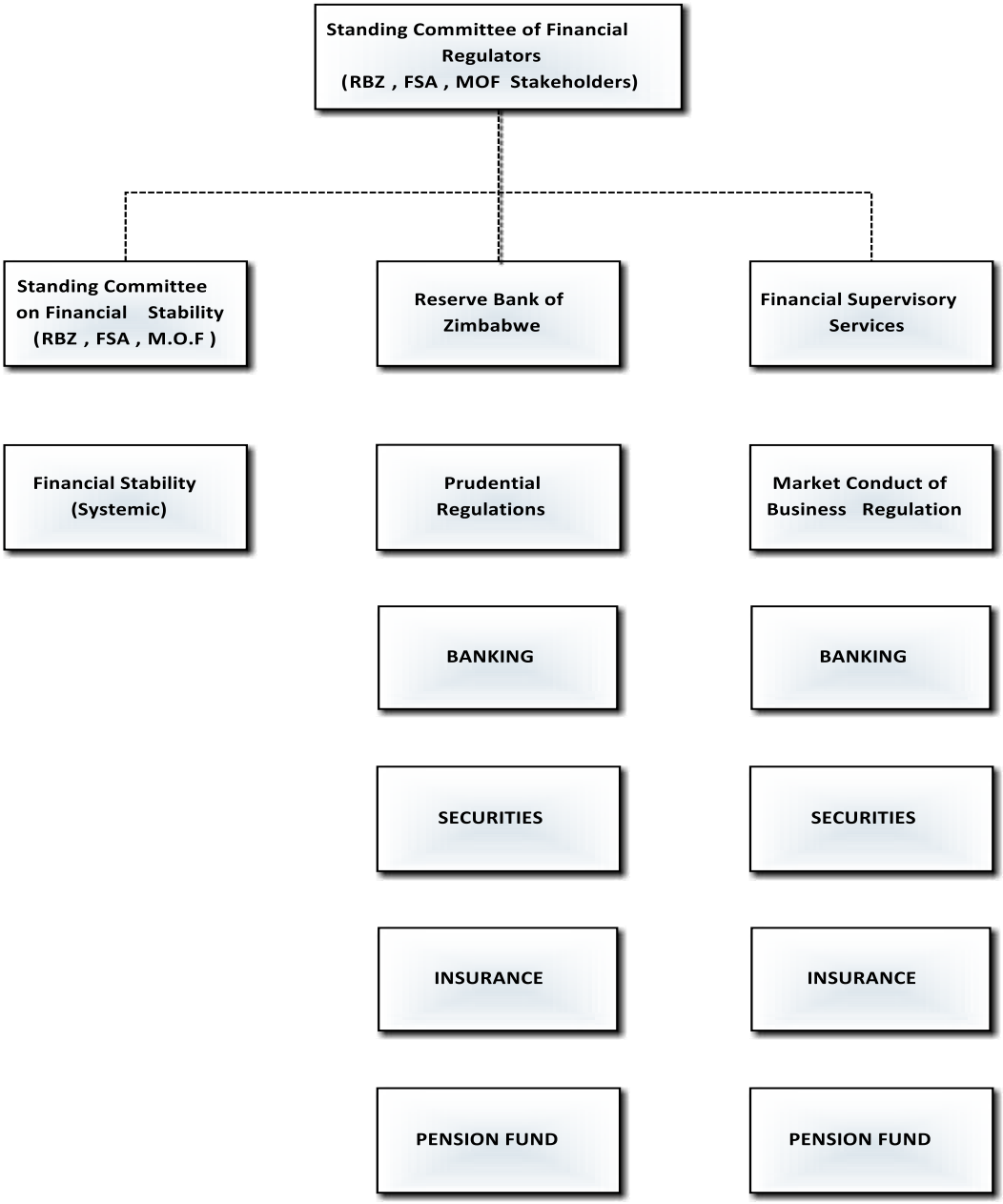
World Competitiveness Report (2011- 2012 and 2012 and 2013.): World Economic Forum Geneva Switzerland (editor, K Schwab) Available from Http:// www./0.iadb.org/intal/intalcdi/PE/2012/12182.pdf and http:// www.logistics.io/wef-global-competitiveness-report-2012-2013

World Economic Forum Competitive (2011): "The Global Competitive Report 2011-2012", http://www.weforum.org/reports/global-competitiveness-report-2011-2012.

World Economic Forum Competitive (2011): "The Global Competitive Report 2012-2013", http://www.weforum.org/reports/global-competitiveness-report-2012-2013.

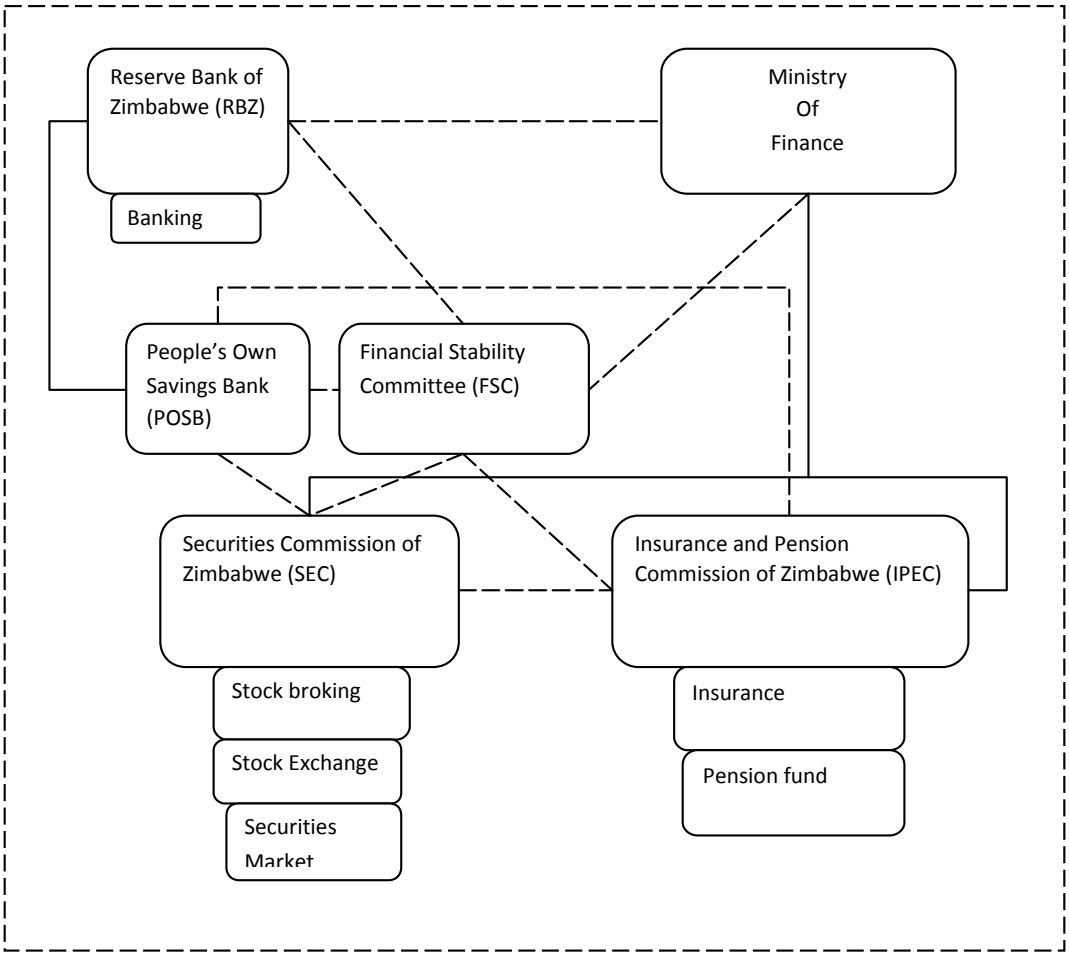
APPENDIX 1

TWIN PEAKS APPROACH FOR ZIMBABWE



The dotted lines denote co-operation amongst regulators

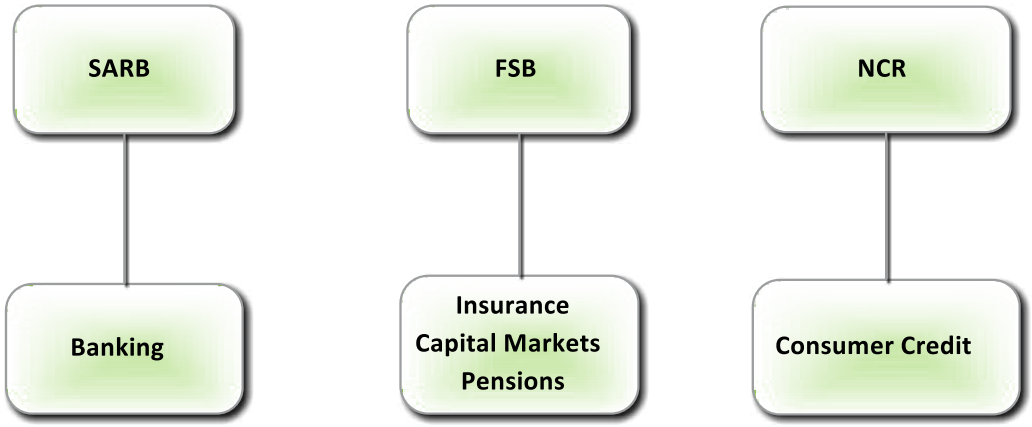
Figure 2: Zimbabwe's Existing Financial Regulatory Structure



Dotted lines indicate a cooperative relationship.
Source: The Author's Model

APPENDIX 2

INTEGRATED APPROACH



The above represents the unified approach adopted by South Africa. South Africa Reserve Bank (SARB) and Financial Services Board (FSB) and National Credit Regulator constitute the integrated approach. Following reform establishing twin peaks- NCR will be absorbed into the FSB which will become the market conduct regulator.

APPENDIX 3

REPORT ON FINANCIAL REGULATION AND SUPERVISION - VIEWS FROM THE BANKING SECTOR PLAYERS, RESERVE BANK OF ZIMBABWE AND THE MINISTRY OF FINANCE

1. How has the regulatory environment evolved over the years? Has it followed international trends?

Bank supervision started around 1985 in Zimbabwe. When it started there was no banking act and the central bank was using moral suasion examinations. The first onsite examinations were done in 1996. The Banking Act was then established in 2000. The Banking Act Chapter 24:20 and Banking Regulations Statutory Instrument 205 of 2000 provide for the registration, regulation, continuous monitoring and supervision of persons conducting banking business in Zimbabwe. The Reserve Bank of Zimbabwe Act Chapter 22:15 empowers the Reserve Bank to supervise banking institutions and foster stability and proper functioning of the financial system. Before 2000 registration of banks was being done by the ministry of finance while supervision was being done by the central bank.

In 2006 the central bank adapted risk based supervision according to international standard. Following the adoption of risk based supervision the Central Bank did a sector wide supervision assessment in addition to its self-assessments. The Central Bank found some supervision deficiency in the banking industry which led to the adoption of the Kings II report on bank supervision. The Central Bank issued a number of supervision guidelines which include; accreditation of credit rating agencies guideline, risk based supervision policy framework guideline, risk management guideline, consolidated supervision policy framework guideline, addendum corporate governance guideline. The minimum internal audit standards in banking institutions guideline and the corporate governance guideline had been issued in 2004.

This list of guidelines covered issues on; board and director evaluation frameworks, board of directors makeup and mandate, role of non-executive directors and guidance on the categories of people who should make up the non-executive directors, appointments to the board and guidance on the maximum term for executive directors, determination and disclosure of executive and non-executive director's remuneration, board meeting frequency, balanced annual reporting, requirement for effective auditing among other governance issues. Following the launch of the King III in 2002. The central bank updated governance guidelines to cover area on directors responsibility, IT governance, business rescue, alternative dispute resolution, risk-based internal audit and shareholder approval of non-executive directors' remuneration. The Central Bank also adopted the 29 Basel principals on bank supervision.

Due to changing financial sector innovations which include financial conglomerates, there was a need to upgrade supervision. Zimbabwe is currently in the process of implementing the Basel II Accord. The accord is broken down into three pillars. The first pillar deals with maintenance of regulatory capital calculated for three major components of risk that bank faces which are: credit risk, operational risk, and market risk. The second pillar deals with regulatory response to the first pillar. It also covers systemic risk, pension risk, concentration risk, strategic risk, reputational risk, liquidity risk and legal risk. The third pillar complements the minimum capital requirements and supervisory review process. Basel III is still to be launched but it contains regulatory measures on capital adequacy, stress testing and market liquidity risk. Zimbabwe lags behind implementing the international standards. However, local banks with head offices in other countries timeously comply with international standards due to their relationships with third party international banks. Zimbabwe is currently amending the Bank Act in line with regional and international standards.

2. What have been its limitations?

The RBZ has been following international bank regulation trends. Currently banks are in the process of implementing the Basel II Accord. We have moved away from the Basel I accord. However we don't have the capacity to fully adapt to international standards due to our economic problems. Currently we have the liquidity problem, banks are having challenges to adjust to new capital requirements levels. Our economy is still small with a deposit base of only USD3.8 billion as of February 2013. The economy is recovering from an economic crisis which saw the local currency being sidelined and the multicurrency regime being adopted. This created problem for all economic players as savings were eroded, financial confidence was lost and the risk multiplied. The RBZ capacity to execute its functions has been affected, the lender of last resort function of the RBZ is not working. The interbank market is very limited. The interbank market was rendered dis-functional following the collapse of confidence in the financial industry. Banks themselves have no confidence in each other, and this has resulted in limited liquidity smoothening in the banking industry. We have very few financial instruments and products on the market, thus limited sources of income for bank at the back of high operating cost. All these problems make it difficult to fully and timely comply with international bank regulation trends.

3. Did it change with the advent of dollarization?, Is it being followed in Zimbabwe? If not why? What are the constraints,

The dollarization regime did not changed bank regulation structure in Zimbabwe. What changed was the implementation of the regulation as banks faced compliance challenges. Before dollarization banks had their assets denominated in the local currency. All these assets were then eroded as the local currency was rendered useless and rejected by the transacting public. The RBZ had no capacity to buy back the local currency. This meant that banks were left with nearly zero balance and they had to start afresh to rebuild the capital requirements and the reserves. Liquidity risk started growing, the credit risk grow too as banks converted

the Zimbabwe dollar denominated loans to US dollars. All the forms of bank risk went up, the operational risk, market risk ,systemic risk, pension risk, concentration risk, strategic risk, reputational risk, and legal risk. The financial confidence, financial products went down and governance issues became difficulty for banks to comply with. Punishing banks with inadequate capital requirement became a problem for the regulator because many banks were affected. This compromised bank regulation and supervision in Zimbabwe.

4. Rationale for financial regulation and supervision

Financial regulation and supervision are carried out for the following reasons:

- To ensure depositor protection following a realization of market failure hence the need for government intervention. This ensures safety and soundness in the financial sector
- To promote market development through law and regulatory infrastructure
- For business to take place in an orderly manner so that there is transparency, accountability and fairness. The purpose of bank supervision is to create order in the banking sector as well as to deal with corporate governance issues where the banks cover up information.
- To ensure availability of an array of financial services
- To encourage a bit of competition with a view to assist customers to identify weak performing banks
- To harmonise national financial regulations with a view to meet international financial standards
- To curb anti-money laundering. Money terrorism otherwise there will be a lot of cross border financial crimes

5. Effectiveness of Regulation and Supervision in Zimbabwe

Bank failure was caused by governance issues, non-transparency operations, non-adherence to rules. The Bank Regulator is partly to blame as it could have detected the signs of failure before it was too late. There is lack of on site supervision capacity.

The other reason that explains bank failure is poor economic performance. Banks wanted to survive and so engaged in illicit deals such as creation of shelf companies that would borrow money from the financial institutions but failing to pay back. Enforcement mechanisms to ensure the borrowers of these companies would pay back were weak because the activities involved people at the helm of banking institutions and hence their juniors could not summon them to pay back the loans. RBZ had to strengthen corporate governance requirements but then is limited by the current legal framework to effectively deal with such.

There are just too many players in the banking sector in addition to relaxed entry barriers. For instance there are 26 commercial banks , 150 micro financial institutions against a GDP of less than $10 billion, economically and actively employed people of less than 1 million people, 72 listed corporate companies which are not

economically active. There are not enough volumes to sustain business hence the banking sector is bound to fail.

The RBZ is more active on off sight front in terms of frequency of reporting and details required. Some of the interviewees (see Appendix 4) were not sure if the RBZ supervision department verifies the correctness of the information it receives from the bankers. In addition, they were not sure if the RBZ carries out bank failure forecast, or if they do it , not sure if they do it properly.

Most of the interviewees expressed that the RBZ is weak when it comes to monitoring and surveillance despite the requisite skills available in their bank supervision department.

i) What informs financial regulation in Zimbabwe?
Bank regulation and supervision is done by the RBZ. The Central Bank uses the Reserve Bank of Zimbabwe Act Chapter 22:15, Banking Act Chapter 24:20 and Banking Regulations Statutory Instrument 205 of 2000 to control and regulate banking activities. The RBZ also borrows or adopt international regulations like the Basel Committee on Banking Supervision (BCBS) which established the Basel accord I, II and III, or from the Institute of Directors in South Africa which introduced the Kings reports, I, II and III. Banking regulations is also adjusted based on historical bank activities like the banking crisis. In this case the RBZ put measures to avoid repetitions of certain bad banking practice.

ii) How does Reserve Bank of Zimbabwe respond to incidents and violations by the financial players? Why does it respond that way?

When the RBZ identifies a troubled or distressed bank it goes through a number of stages in correcting the problem. The Central Bank uses informal and formal ways to correct a troubled bank. During the informal phase the Central Bank engage moral suasion. A memorandum of understanding is signed between the Central Bank and the troubled bank. The memorandum contains the corrective actions which need to be done. If the informal ways fail the central bank then moves to the formal procedures. The central bank will start by issuing a corrective letter. The letter contains the measures and the time frame within which a troubled bank has to correct the cited problem. If the troubled bank fails to honour the corrective letter then the central bank will start exercising it powers which includes, removing certain employees from the trouble bank, suspending certain bank operations, changing the board members, engaging resident manager, appoint a curator, withholding of banking license or finally placing the troubled bank under liquidation. The RBZ does not publish the problem to the public. This it does so as to avoid public panic which will worsen the banks problems.

RBZ respond is guided by corrective actions as enshrined in the Banking Act,

section 48. The actions range from issuing a warning or written instruction, imposing a monetary penalty, removal of directors, direct the institution to suspend business, placing the bank under curatorship.

ii) Why does it respond that way?
Since dollarization, oversight role by the RBZ has not been effective. There is too much concentration on the on the risky banks leaving out the so called less risky banks. RBZ tends to visit banks only when they are convinced that they are risky. However, there is no bank which is too big to fail, so the rating the RBZ places on the banks during its supervision exercises does not help. Whenever banks have problems, the RBZ gets to know it but it takes too long to react. There is regulatory forbearance and the lack of financial resources by the RBZ has stifled the frequency of onsite supervision. The IMF reports confirm that onsite visits have not been done properly. There is need to regulate borrowing by RBZ supervisory employees from the banks as this compromises effectiveness on bank supervision.

There is adequate human resources in the RBZ supervision department. They are actually the best set of regulators in the region. Moreso, some of them are IMF and MEFMI consultants. The adequate skills within the RBZ's bank supervision department is not translating into good supervision. It appears that there is regulatory forbearance. During the financial crisis, the RBZ was issuing circulars and notes to the financial institution without enforcing implementation of what the circulars and notes called for.

It respond that way in a bid to regularize violations by players and to normalize the situation like in case of curatorship, whereby the continued trading of an unfit financial company might lead to failure of many players(systemic risk).

iii) Which indicators are used to measure effectiveness of the regulator?
Some of the indicators cited in the interviews include many indicators are regular conduct of inspections in the form of onsite and offsite examinations, regular meetings with banks, formulation of policies that promote financial soundness, swift reaction to bank problems and resolving amicably banking problems, professional conduct free from political interference in regulation of banks.

iv) How has the regulator performed based on those indicators?
The Regulator performed fairly during the past years though more could be done in the areas of regular onsite inspections, swift reaction to problems. The regulator has performed badly to early detection of problem, only coming in when it is already too late. Politics has been accommodated a lot, for example in forced compulsory of foreign bank accounts of companies by the regulator to pay for government forex commitments. That action by the

regulator affected the trust and confidence of all concerned. That action infringed on rights of companies to their investments in banks.

Policy formulation especially in the area of maintaining stable inflation failed dismally with improper intentions that failed to solve the problem of high inflation.

6. What lessons do we draw from bank closures during the period 1995-2013? (establishment of efficient and flexible regulatory structures)

There are a number of bank regulatory lessons that we have to draw from the banking crisis period. Globalization, financial liberalisation and financial innovation have created financial conglomerates and financial holdings. These groups have been abused during the banking crisis period. There is highly need of consolidated and collaborative supervision. The current regulatory model has created a multiple of financial sector regulatory bodies. These bodies need to collaborate and consolidate supervision to avoid supervision loopholes. Governance issue was one of the major reasons why banks failed during the crisis period. Banks were not fully complying with governance issues. The international measures which the central bank was adopting were not fully supported by the banking act. This made it difficult to criminalise actions of some banks directors. This calls for constant and speedy amendment of the Banking Act and the RBZ Act in line with banking developments.

The multicurrency regime has created capacity problems for the Central Bank, evidenced by the RBZ balance sheet. The Central Bank has a debt bill amounting to USD1.2 billion. This has results in skills flight, capacity challenges and has limited the central bank in performing its functions. The emergence of new risks calls for experienced employees. Thus there must be a fast road map to capitalize the Central Bank. Failure to capacitate the Central Bank might cause troubled banks to fail as there is no facility to bail out troubled banks. Also, the Central Bank need to improve its supervisory role, more monitoring and evaluations must be done. The Central Bank must work towards insuring effective and frequent onsite supervision and a robust early warning system. Another reason which caused banks to fail was non-performing loans. There is too much risk in the banking industry, as evidence by a limited interbank market and high non-performing loans of about 13%, according to the 2013 national budget. This calls of market risk neutralization in the form of establishing a credit rating bureau.

The key lessons are with respect to risk management especially credit and market risk. These are key to ensuring stability of a financial system. Mismanagement of credit risk which resulted in non-performing loans has an adverse impact on profitability and capital which in turn affect the going concern of a bank. High incidence of insider loans which turned out to be non-performing is bad for banking business.

Market risk should be managed by all concerned. Uncontrollable price movements in the money market, forex market, commodities market and equity, all driven by hyperinflation is not good for the effective working of markets. Such adverse movements impact negatively on value of banks balance sheets with respect to assets in equities form, foreign currency form, and financial instrument form.

Another key lesson was on corporate governance which is vital for effective management of financial companies. The fact that most of the banks which collapsed had poor governance systems evidenced by non-functional board committees, incompetent senior management, incidence of creative accounting etc indicates the need to improve corporate governance. In this regard the RBZ made efforts to change the banking regulations including shareholding, office holding of shareholders (if one is a shareholder, they cannot form part of the management). The crisis saw the need for separation of duty within executive managers of banking institutions (for checks and balances) and the need to set qualifications of individuals to sit on the boards of financial institutions and the need evaluate the Board of Directors in order to assess their effectiveness.

We can have the regulations but bankers just do not comply. It is however, key to note that compliance is actually good for the bankers themselves. There is need for amendments to the legislation hence the need to draft acts to strengthen banking supervision. Legislation should however, be complimented by effective monitoring. Moreso, RBZ needs to establish financial performance of the banks and use it to make predictions about the soundness of the banking institutions.

The 2003-4 environment gave the banks scope to make more money from non-banking activities such as trading in bricks, blocks of flats, vehicles etc. the crisis exposed the banks to some of the vulnerabilities that came with it.

The need for capital adequacy is paramount given the unsoundness of the banking sytem. The banking institutions have to be adequately capitalised. Due to capital erosion that the banks faced during the changeover from the Zimdollar era to the multiple currency regime, banks have had to raise new capital .The RBZ had to set new capital threshold to strengthen banks as this would save as a fall back position in case of bank failure. The quality and quantity of capital is however, critical because of the relationship that capital has with a number of economic indicators. The Zimdollar era allowed a lot of speculative behaviour. Now with the dollarised economy, the ball game has changed. The banks now require a lot of innovation and interbank trading is no longer the case. The assets of banks have reduced drastically. Banks can trade both locally and internationally but there are no treasury bills in the local market. The dollarized era has brought with it strong competition for and this is good for clients as it increases bank efficiency.

Printing too much money created our own supervision problems. We learn the need to print money in line with our production capacity. Whatever currency is available, the regulators need to use it wisely.

Economic fundamentals just have to operate functionally if we are to have a sound financial sector. In addition, there is need for more protection of deposit, pensions and securities and this can be enabled through the presence of an ombudsman. There is need for banks to emphasise on enterprise risk management. In addition, they need to capacitate themselves skillswise as they suffered serious skills flight. The new risks that are emerging in the financial sector require new skills to tackle them.

The dipping of hands by the bank management was an indication that there were no other resources to tap from.

7. Do you have the capacity (corporate governance, software, human skills) required to comply with the set regulations?

Senior management sends staff on training albeit the low financial resource levels. Other countries had technical assistance from the international community but Zimbabwe did not have over more than 10 years back. The RBZ does not have capital, hence the weak balance sheet might not attract highly skilled.

The RBZ feels that it has adequately trained staff who can do their duties without hindrances. In fact some of them go to train other bankers in countries like Rwanda, Tanzania and Kenya.

The bank feels that it is technologically capacitated as the RTGS system is operational and the Bank has the right to stop electronic submission of reports. Further the IMF comes to identify capacity gaps as technical assistance was suspended. The Bank also benefits from MEFMI tailor made training on banking supervision.
RBZ is capacitated but cannot go beyond what they are doing because of missing ingredients. Some of the banks (eg Royal Bank and Genesis) surrendered their operating bank licences because there is no business in the financial sector. The RBZ is trying to supervise institutions that are not liquid which in itself is a challenge.

8. How does your level of skills match with those from the region?

The Supervision department has highly qualified personnel with adequate skills on banking supervision. Zimbabwe was a pioneer in Africa to implement Risk based Supervision beginning 2006. As a result a number of countries (e.g. Lesotho, Swaziland, Uganda, and Rwanda) have benefitted from Zimbabwe through capacity building on the same. Moreso, a number of RBZ staff are on MEFMI and IMF technical teams that offer support to various countries on bank supervision

9. What are the challenges in Financial Regulations and Supervision?

The capital requirement is too high. Most institutions have capital around $25million while the minimum capital requirement was raised to $100million. The RBZ should relax the timelines. Too much regulatory space for institutions might not be good as this tends to stretch its resources (depth of skills) for effectiveness.

The trend obtaining in the banking sector is not in line with what should prevail in a normal environment. Most of the depositors are small traders who can have huge balances in their accounts but can withdraw them overnight, leading to ban sector instability. Most deposits are transitory; most are salaries. This means that the monies are withdrawn as soon as these deposits reflect in the accounts.

Legal framework gaps especially on bank resolutions aspects. This is different from countries like Tanzania and the US whose resolution provisions are more effective.

Certain risks have emerged prominently with the advent of dollarization and these include capital erosion where banks had nil capital, liquidity challenges as there are only short term deposits, bank have no core level of deposits and their financial intermediation is low. There are high levels of robbery cases now that the economy is trading in hard currency and banks have had to tighten security at the bank entry points. In addition there are now high levels of non-performing loans in the dollarisation era given the prevailing macroeconomic environment that is characterised by low export earning, high pressure on imports, company closure. There is no liquid working capital and this heightens liquidity challenges inter-banking activity is not very effective in the absence of tradable paper money. The absence of lender of last resort in the banking sector worsens the liquidity situation as banks are not keen to trade amongst themselves leading to a situation where there are banks that are well capitalised while others are not.

The RBZ supervision department concentrates on high risk areas and pays less attention to the banks they would have rated as sound banks. However, it has been proven globally that even the so called sound banks can fail. This calls for the RBZ to give full attention to all the banks in order to avoid collapse. Whilst the RBZ regards ratings as minimal they engage in continual dialogue with the banks.

Main limitation is human skills in risk management especially market risk and unavailability locally of appropriate hedging instruments to manage risks. For example, Disclosure of information is quite expensive and it requires hiring of specialized skill by the banks.

Due to skills flight the banking sector suffered, there are inadequate skills to match new risks that are cropping up frequently due to financial innovation and new products that are being introduced in the market.

Whilst the RBZ follows the international standards, it lags behind as it does not have the enough capacity financially. International best practices on bank supervision keep on changing quite fast for countries like Zimbabwe to adopt. What the country does is just to make sure that it does more lag behind that much.

The Banking Act is not up to speed with regulatory changes necessitated by financial innovation e.g. mobile money. However, strengthening of legislation works if the banking sector management is willing otherwise they only try to comply but without effective information disclosure

10. Would you suggest any Options to improve financial regulation and supervision in Zimbabwe

- Consolidated supervision
- Legal regulatory framework to be strengthened
- Strengthen RBZ's institutional capacity in terms of boosting their financial resources for them to effectively execute their duties on financial supervision.
- RBZ to do thorough job on auditing of banks to decide on what needs to be shared with the public
- There is a dent of confidence , try to restore it
- RBZ to ensure good corporate governance.

APPENDIX 4: LIST OF INTERVIEWEES

1. Mr Mukarati – Agribank
2. Mr Muringani- AgriBank
3. Mr C Mutambirs FBC
4. Mr Nyarota –RBZ Economics Research Department
5. MR W. Nakunyada- RBZ Economics Research Department
6. Mr S. Biyam- CEO of Bankers Association of Zimbabwe
7. Mr P. Madamombe- RBZ Bank supervision
8. Mr Kanhai- RBZ Bank Supervision
9. Ms L Chaavhure- RBZ Bank Supervision
10. Mrs Takavarasha, Ministry of Finance
11. Mr C Munjoma, Ministry of Finance
12. Mr Chidavayenzi Ministry of Finance
13. Mr G. Chitambo- Executive Director of ZAMFI

rdgraphix +263 772 403 625

Zimbabwe Economic Policy Analysis and Research Unit (ZEPARU)

55 Mull Road
Belvedere
Harare
Zimbabwe
Tel: +263 4 778 423 or 785926/7
Email administration@zeparu.co.zw
Web: www.zeparu.co.zw