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# Lengthening Financial Contracts, an Issue in the West Africa Economic and Monetary Union (WAEMU) Region

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**Maturity mismatch, stringent bank regulations, and an underdeveloped capital market characterize the West Africa Economic and Monetary Union (UEMOA) region.**

The key constraints faced by the banking sector in the region include the following:

- The main source of long term funding for banks is time deposits (over 24–month maturity);
- The regulations by the *Banque Centrale des Etats de l'Afrique de l'Ouest*- (BCEAO) stipulate that the ratio of medium and long term loans to time deposits (transformation ratio) must not exceed 25 percent;
- High corporate tax rates are a serious burden and restrict the amount of available resources to be leveraged by banks (Table 1).

**Table 1: Corporate tax rates in UEMOA countries**

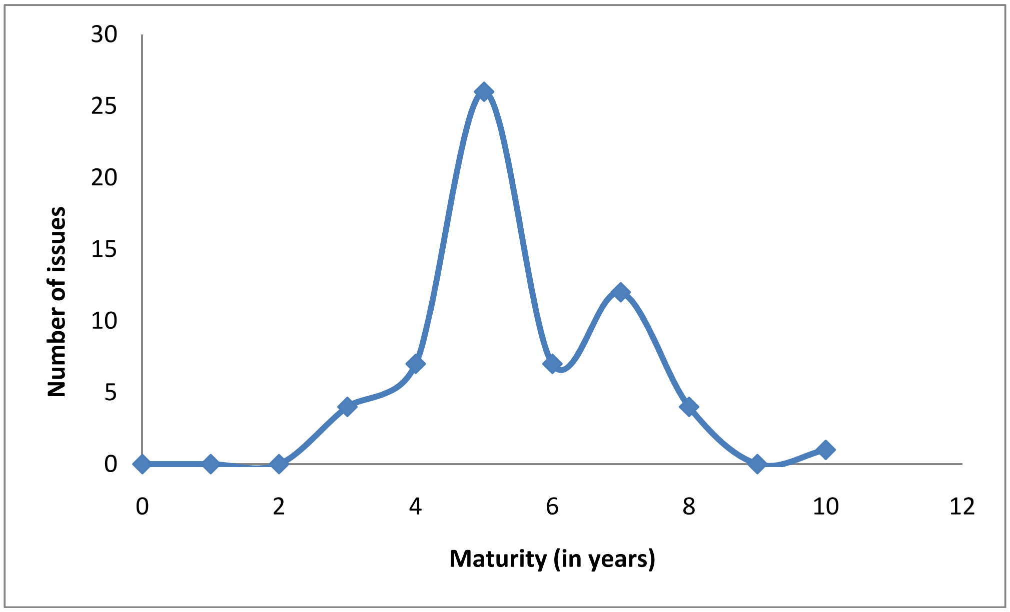
| WAEMU member country | Tax on Profits (%) | Labor tax and contributions (%) | Other taxes (%) | Total tax rate (% profit) |
|---|---|---|---|---|
| Benin | 16.7 | 32.7 | 23.9 | 73.3 |
| Burkina Faso | 16.1 | 22.6 | 6.2 | 44.9 |
| Cote d'Ivoire | 9 | 20.1 | 15.7 | 44.7 |
| Guinea-Bissau | 14.9 | 24.8 | 6.1 | 45.9 |
| Mali | 12.9 | 32.6 | 6.6 | 52.1 |
| Niger | 20.1 | 19.6 | 6.8 | 46.5 |
| Senegal | 14.8 | 24.1 | 7 | 46 |
| Togo | 11.1 | 28.3 | 13.3 | 52.7 |

*Source: 2010 doing business indicators.*

**The bond market remains underdeveloped** due to many constraints, including high transaction costs and red tape related to bond issuance.

- The supervisory authority of the Bourse Régionale des Valeurs Mobilières (BRVM), namely the Conseil Régional de l'Epargne Publique et des Marchés Financiers (CREPMF), requires issuers to guarantee 100 percent of the issue value (interest plus capital) in order to protect investors. There is virtually no secondary market mainly because of the buy and hold attitude of investors.
- New bond issuances are processed on a quarterly basis. It takes 3 to 9 months to a get a bond issuance approved by the CREMPF;
- 63 bond issuances took place on the BRVM from 1999 to 2009. The maturity is mostly medium term (Figure 1).

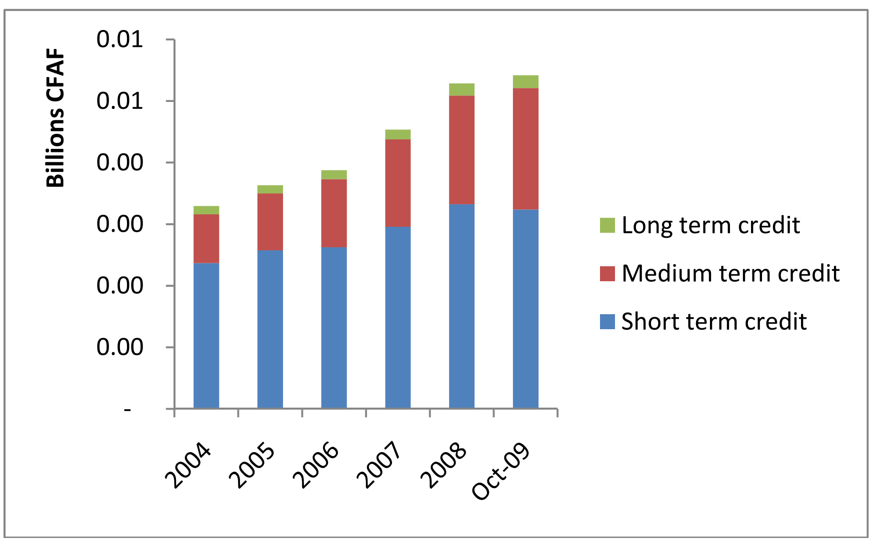
**Figure 1: Maturity distribution of bonds issued on the BRVM, 1999-2009**




*Source: The 2006/2007 année boursière and BRVM website.*

**The financial needs in the region have evolved**. This puts extra pressure on banks in the region to raise long term resources and develop new and innovative products such as infrastructure finance, leasing, and housing finance (Figure 2);

**Figure 2: Bank credit to the economy (in billion of CFAF) in the UEMOA**




*Source: Monetary and Financial Statistics Bulletin, BCEAO.*

**Long term funding is limited**. There is a possibility to tap into the funds available through the classification agreement mechanism (*Accords de Classement*) of the BCEAO, but few banks have succeeded in complying with its conditions (see Box 1).

***Box 1: BCEAO Classification Agreement***

The BCEAO provides credit institutions with the possibility to refinance their loans which are eligible for the classification agreement mechanism (*Accords de Classement*). In so doing, credit institutions must submit applications that include detailed information about the financial situation and the management of companies in their loan portfolio. The agreement is provided for a period that cannot exceed one year. All credit institutions must maintain a minimum share of 60% of loans benefiting from a rating agreement (and therefore eligible for refinancing) in their loan portfolio. This portfolio structure ratio is designed to control credit risk in the banking system. Given the long process imposed by the classification agreement, banks' portfolio structure, and the inconsistency between its timing and bank reporting agenda, the use of this source of refinancing remains limited. According to the 2008 BCEAO annual report, 661 credits benefited from refinancing through the classification agreement corresponding to less than 10% of total credit to the economy. Financial institutions in the UEMOA zone hardly abide by the 60% portfolio structure ratio. Enforcing that stringent ratio would force banks to improve their portfolio structure ratio, but would mean denying credit to 'risky clients', mainly SMEs.

**Recommendations**

- Revisit the current transformation ratio rule, weighing the benefits from additional long-term funding that would be provided from a higher ratio against possible adverse consequences on the stability of the banking system. One option is to expand the list of stable deposits used as a base to calculate the savings that can support long-term lending;

- Rationalize and streamline procedures and facilitate the refinancing process through the classification agreement mechanism (*Accords de Classement*) of BCEAO;

- Develop new products to collect long term savings (life insurance, pension and complementary retirement plans, mutual funds, etc.) and provide fiscal incentives to make them attractive for investors;

- Encourage long-term funding by Development Financial Institutions to bridge financial needs in accordance with the WAEMU Heads of State's declaration in Bamako on February 20, 2010.

Comments and suggestions can be sent to:

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