INTERNATIONAL MONETARY FUND

IMF Country Report No. 14/315

DEMOCRATIC REPUBLIC OF THE CONGO

FINANCIAL SECTOR STABILITY ASSESSMENT

October 2014

This Financial System Stability Assessment on the Democratic Republic of the Congo was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on May 23, 2014.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF THE CONGO

FINANCIAL SYSTEM STABILITY ASSESSMENT

May 23, 2014

Approved By
Christopher Towe and Kal Wajid
Prepared By
Monetary and Capital Markets Department

This report is based on the work of the Financial Sector Assessment Program (FSAP) mission that visited the Democratic Republic of the Congo in June and September/October 2013. The FSAP findings were discussed with the authorities during the Annual Meetings, and the Article IV consultation mission in February 2014 and the 2014 Spring Meetings.

- The FSAP team was led by Maria Oliva (IMF) and Cédric Mousset (World Bank). From the IMF, it comprised Adrian Armas, Kay Chung, Nombulelo Duma, Felix Fischer, Jacques Loubert, and Jean-Paul Mvogo; from the World Bank, it included Philippe Aguéra, Maria do Ceu da Silva Pereira, Dorothée Delort, Franz Le Lesle, Pierre Lemoine, and Jose Garrido. The mission met with the Governor of the Central Bank of the Congo (BCC), the Deputy Minister reporting to the Prime Minister responsible for Ministry of Finance (MOF), as well as staff at the BCC, MOF, Ministry of Justice, and other government agencies. It also met with representatives from public and private financial institutions, professional associations, and associations of auditors and lawyers.

- FSAPs assess the stability of the financial system as a whole and not that of individual institutions. They are intended to help countries identify key sources of systemic risk in the financial sector and identify policies to enhance its resilience to shocks and contagion. Certain categories of risk affecting financial institutions, such as operational or legal risk, or risk related to fraud, are not covered in FSAPs.

- This report was prepared by Maria A. Oliva.

CONTENTS

GLOSSARY 4

EXECUTIVE SUMMARY 5

INTRODUCTION 7

FINANCIAL SECTOR STRUCTURE AND PERFORMANCE 9

A. The Banking Sector and Financial Stability 9

B. The Nonbanking Sector and Financial Stability 15

RISKS AND RESILIENCE OF THE BANKING SECTOR 18

A. Financial Sector Vulnerabilities 18

B. Banking Sector Resilience 20

C. Credit Risk 20

D. Liquidity Risk 23

E. Interbank Contagion Risk 24

FINANCIAL SECTOR SUPERVISION AND REGULATORY FRAMEWORK 24

CRISIS MANAGEMENT AND SAFETY NETS 27

A. Crisis Preparedness 27

B. Responding to a Crisis 28

C. Deposit Insurance System 29

DEVELOPMENT AND MARKET STRUCTURE 29

ANTI-MONEY LAUNDERING 31

FIGURES

1. Banking Systems Balance Sheet 11
2. Comparative Indicators of Banking System Soundness 13
3. Comparison of Microfinancial Buffers, 2009 vs. 2013 18
4. Estimated Banks' Capital Needs if the Exchange Rate Depreciates Sharply 21
5. Large Concentration Exposures 23
6. Supervisory Structure 25

TABLES

1. Selected Economic and Financial Indicators, 2011–2019 8
2. Structure of the Banking System 10
3. Financial Soundness Indicators, 2010–2013 14
4. End-2012 Banks' Income Statements 15
5. Number of Microfinance Institutions Not Meeting the Regulatory Norms 16
6. Risk Assessment Matrix 19
7. Solvency and Liqudity Stress Tests 22
8. Key Recommendations (Extended) 32

APPENDICES

I. The Central Bank: Autonomy and Monetary Policy Tools 37
II. De-dollarization: Preconditions, Operational Aspects, and Risks 40
III. The Resolution of the Banque Congolaise 42
IV. Observance of the Basel Core Principles 43
V. Stress Test Matrix 59

Glossary

ACH	Automated Clearing House
AML	Anti-Money Laundering
ARTPC	Authority for the Regulation of the Posts and Telecommunications of Congo
BC	Banque Congolaise
BCC	Central Bank of the Congo
BCP	Basel Core Principles
BSA	Bank Supervision Application
BTR	BCC Treasury Bills
CADECO	Caisse d'Epargne du Congo
CAR	Capital Adequacy Ratio
CDD	Customer Due Diligence
CGF	Congolese Franc
CFT	Combating the Financing of Terrorism
COOPECS	Savings and Loan Cooperative
DSIF	Directorate for the Supervision of Financial Intermediaries
FATF	Financial Action Task Force
FPI	Fund for the Promotion of Industry
FSAP	Financial Sector Assessment Program
FSIs	Financial Stability Indicators
FSSA	Financial Sector Surveillance Assessment
INSS	National Social Security Institute
MDG	Millennium Development Goals
MFI	Microfinance Institutions
MOF	Ministry of Finance
MOU	Memorandum of Understanding
MSME	Micro, Small, and Medium Enterprises
NPL	Nonperforming Loans
OHADA	Organization for the Harmonization of Business Law in Africa
PFM	Public Finance Management
PSD	Payment Systems Directorate
RCCM	Trade and Personal Property Credit Resister
RTGS	Real-Time Gross Settlement
SME	Small and Medium Enterprises
SMNI	National Interbank Electronic Payment System
SNP	National Payment System

EXECUTIVE SUMMARY

The Congolese financial sector has recovered from the crisis of 2009 but is at a crossroads. Although reforms have been initiated, the system remains shallow, highly dollarized, and characterized by balance sheet fragilities. The authorities have announced a de-dollarization process, but greater progress on reforms to strengthen the financial system is needed to support financial deepening and economic growth.

The team's analysis suggests that the financial system remains vulnerable. Resilience to shocks is undermined by the lack of risk-based supervision, lax regulation and weak enforcement of existing regulations, low profitability, and an excessive reliance on sight deposits. The system is also characterized by significant credit concentration, and the default of a large borrower would have systemic implications.

Swift action to strengthen banking supervision is necessary. The passing of the Central Bank of Congo (BCC) and Banking laws clarifying roles and functions is urgently needed. The strengthening of the BCC should encompass not only its recapitalization, with an estimated fiscal cost of over 4 percent of the GDP, but also improvements of its governance and accountability frameworks and the rationalization of its operating costs. The central bank should step up efforts to monitor and address banks' compliance with laws and regulations, and to align the regulatory framework with international best practice.

Steps are also needed to improve the capacity for micro- and macroprudential supervision. The implementation of risk-based supervision for individual banks is a critical prerequisite for effective crisis prevention. Assessments of bank-specific and systemic soundness are severely handicapped by weak supervisory data and other information gaps. There are significant weaknesses in accounting and auditing practices and, even if indicators suggest high capitalization levels, a more detailed analysis suggests banks are underprovisioned, partly owing to lax definitions of nonperforming loans and provisioning rules.

A well-defined crisis management framework and the upgrading of the banking sector's resolution and liquidation framework is also needed. The resolution framework needs to be streamlined, including by reinforcing the liquidator's powers. This would help eliminate significant delays, and reduce unnecessary costs to the budget. The adoption of any (limited) deposit guarantee scheme on Congolese franc (CGF)-denominated deposits should be conditioned on steps to limit moral hazard and the assurance of sufficient fiscal backstops.

Financial inclusion is growing but more progress is needed in developing payment systems, facilitating use of financial services, and strengthening nonbank sector supervision.
The consolidation and strengthening of the microfinance sector and the reform of the insurance and pension sectors could facilitate the expansion of financial services and attract long-term investors. A modern payments system and a credit registry need to be implemented urgently to support the strengthening of the financial sector and the de-dollarization efforts. Also, it is critical that action is taken to address the situation of a number of nonbanking institutions that are facing important operational and financial difficulties. Money laundering risks are important and result from the large cash-based informal economy, large foreign exchange transactions, and the buoyant real estate market.

Recommendations[1]	
Recommendations	**Priority**
Financial stability, supervision, and crisis management	
Complete the clean-up of the BCC's balance sheet and its recapitalization.	Short-term: A progress report on streamlining the BCC's operating costs is due by end-May.
Adopt the new banking law and the central bank law to reinforce the BCC's independence, responsibilities, and its transparency.	Short-term: The drafts are already at the Ministry of Finance (MOF) level. The Banking Law is expected to be approved in the coming months.
Strengthen the BCC's validation and analysis of data.	Short-term: Preparation is to start immediately with the reinforcement of the technical capacity, and progress will be achieved over time.
Establish a legal framework and operational mechanism for crisis prevention, preparation, and management.	Medium-term: Preparatory work could start in the coming months.
Strengthen the legal and regulatory framework for bank intervention and liquidation.	Medium-term: Preparatory work could start in the coming months.
Introduce effective risk-based supervision.	Medium-term: Preparatory work could start soon, supported with IMF technical assistance (TA), but progress will require time.
Strengthen regulations on provisioning and classification of nonperforming loans.	Short-term: There is some work ongoing but much more is needed to align current practices to best practices.
De-dollarization	
Adopt a medium-term roadmap for de-dollarization, with realistic timelines and the prioritization of measures, and that takes into account the risks of de-dollarization.	Medium-term: The pre-conditions for de-dollarization need to be in place. The current plan needs to be improved with realistic timelines, medium-term targets and prioritization.
Financial inclusion	
Adopt a revised law on leasing.	Medium-term
Strengthen supervision of microfinance and provide for the liquidation of institutions that are not viable.	Medium-term: The World Bank 6-year project on financial infrastructure and markets development signed on April 2014 covers this aspect.
Adoption of a restructuring (or liquidation) plan of the CADECO based on minimization of risks and fiscal costs.	Short-term
Financial infrastructure	
Review and adopt the draft law on payment systems.	Short-term
Make the new credit registry operational.	Short-term
Amend the law on commercial courts, adapting it to OHADA.	Medium-term
Nonbanking financial institutions	
Promulgate an upgraded insurance code to strengthen governance and the powers of the supervisor.	Medium-term: The liberalization of the sector is in process and should materialize in the coming weeks.

[1] Table 6 provides an extended list of recommendations. The De-dollarization Technical Note also provides a roadmap for an orderly process aimed at preserving financial stability.

INTRODUCTION

1. Democratic Republic of the Congo (DRC) is a fragile economy that is re-emerging from years of conflict and instability. Tensions in the eastern provinces of the country seemed to be dwindling but end-December 2013 attacks evidenced continuing security risks. The November 2011 presidential elections gave President Kabila's coalition majority control in parliament, which helped restore a degree of political and social stability in the vast majority of the country. However, a major opposition party challenged the election results. After months of negotiations, in October 2013 President Kabila announced a "government of national cohesion" that has yet to be appointed and does not include the major opposition party. Enormous economic and social challenges remain, with over 63 percent of the population living in poverty, unemployment rates exceeding 45 percent, and with all the Millennium Development Goals (MDG) set for 2015 projected to be missed. Public institutions are weak and implementation capacity for much needed reforms is insufficient.

2. The economy has been growing vigorously and inflation is now in the single digits. GDP growth is estimated to have been at 8.5 percent in 2013, and over 8 percent in 2014–16 (Table 1). Mining sector activities are the driving force for growth, with public sector investment, agriculture, and manufacturing also helping to broaden the economic base. Inflation has declined significantly due to fiscal discipline and a stable exchange rate, but the economy is highly exposed to pass-through from global commodity prices. Monetary policy interventions have been limited including because of concerns about the cost to the Central Bank (BCC)'s already weak balance sheet. International reserves have been increasing in the past few years, but remain insufficient (at less than two months of imports).

3. The economy is highly dollarized, with consequences for the conduct of macroeconomic policy, financial development, and systemic stability. About 90 percent of banking sector deposits and lending are in U.S. dollars, and prices of some goods, services, and financial activities are indexed to the dollar. High dollarization has contributed to a weak monetary policy transmission mechanism and increases the system's exposure to liquidity shocks, given that banks' minimum regulatory requirements are defined in domestic currency and the central bank has only a limited capacity to provide dollar liquidity (Appendix I).

4. The authorities have announced their intention to introduce a "de-dollarization" program, but success will depend on bolstering public confidence in the domestic currency and in the BCC (Appendix II). The central bank will need to be recapitalized to enable it to exercise its monetary policy function credibly, supported by a legal mandate that enshrines its operational independence and its responsibility to pursue price stability (its main objective) and support financial stability. This will need to be coupled with a banking law that clearly defines the applicable legal and regulatory framework for the Congolese financial sector, but also with a reinforcing of

Table 1. Democratic Republic of the Congo: Selected Economic and Financial Indicators, 2011–2019

	2011	2012	2013	2014	2015	2016	2017	2018	2019
			Est.			Proj.			
	(Annual percentage change; unless otherwise indicated)								
GDP and prices									
Real GDP	6.9	7.2	8.5	8.7	8.5	7.9	7.3	6.4	5.7
GDP deflator[1]	10.3	7.5	0.7	1.3	2.9	4.0	4.8	5.6	5.1
Consumer prices, period average[1]	15.5	2.1	0.8	2.4	4.1	4.8	5.3	5.5	5.5
Consumer prices, end-of-period[1]	15.4	2.7	1.0	3.7	4.5	5.0	5.5	5.5	5.5
External sector									
Exports, f.o.b. (U.S. dollars)	19.9	-13.7	16.6	16.5	12.1	11.9	11.5	7.5	8.8
Imports, f.o.b. (U.S. dollars)	23.8	-7.0	16.3	5.1	6.2	10.1	6.4	8.6	6.8
Export volume	19.6	-1.7	25.0	7.5	12.1	11.5	10.8	6.8	8.1
Import volume	5.0	-7.8	15.4	8.7	7.9	10.5	6.4	8.3	6.4
Terms of trade	-11.8	-11.5	-7.2	12.4	2.0	1.0	0.5	0.4	0.3
	(Annual change in percent of beginning-of-period broad money; unless otherwise indicated)								
Money and credit									
Broad money	23.2	21.1	18.1	10.1	13.1	…	…	…	…
Net foreign assets	-3.7	22.9	2.3	10.7	7.1	…	…	…	…
Net domestic assets	25.9	-1.9	15.7	-0.5	6.1	…	…	…	…
Domestic credit	19.2	-4.6	14.5	5.2	5.9	…	…	…	…
Of which:									
Net credit to government (annual percent change)	11.7	-18.9	3.6	-0.2	0.3	…	…	…	…
Credit to the private sector (annual percent change)	16.7	25.6	26.5	11.9	12.0	…	…	…	…
	(Percent of GDP; unless otherwise indicated)								
Central government finance									
Revenue and Grants	18.0	20.1	17.4	17.4	18.2	19.3	19.3	19.1	18.9
Revenue	12.4	14.9	13.0	13.9	14.0	14.7	14.8	14.9	15.0
Grants	5.6	5.2	4.4	3.5	4.2	4.6	4.5	4.2	3.9
Expenditure	19.1	19.5	19.1	19.6	19.9	20.9	22.3	22.7	22.0
Domestic fiscal balance (cash basis)	-1.1	1.2	0.2	0.5	0.7	0.7	0.2	-0.3	-0.8
Net borrowing/lending (overall balance, incl grants)	-1.2	0.6	-1.7	-2.2	-1.7	-1.6	-3.0	-3.6	-3.0
Investment and saving									
Gross national saving	10.5	12.3	11.2	12.2	13.7	15.8	17.4	17.8	17.5
Government	1.1	3.7	2.9	3.4	3.8	4.3	4.2	4.0	3.9
Nongovernment[2]	9.4	8.5	8.3	8.8	9.9	11.5	13.2	13.8	13.6
Investment	16.5	20.3	21.3	21.6	22.7	23.8	25.0	25.1	24.2
Government	4.4	6.1	6.4	6.2	6.6	7.0	7.9	7.7	6.5
Nongovernment	12.1	14.2	14.9	15.3	16.1	16.8	17.1	17.4	17.7
Balance of payments									
Exports of goods and services	45.5	34.1	36.4	39.1	40.2	41.3	42.3	41.8	42.4
Imports of goods and services	50.3	40.0	42.5	41.1	39.9	40.1	39.2	39.2	39.0
Current account balance, incl. transfers	-5.9	-8.0	-10.1	-9.3	-8.8	-7.8	-7.4	-7.1	-6.4
Current account balance, excl. transfers	-9.3	-10.9	-15.4	-14.0	-12.9	-12.0	-11.5	-11.1	-10.3
Gross official reserves (end-of-period, millions of U.S. dollars)	1300	1645	1695	1905	1955	2165	2425	2575	2725
Gross official reserves (weeks of non-aid-related imports of goods and services)	7.7	7.7	7.7	8.4	8.1	8.6	8.8	8.5	8.3
	(Millions of U.S. dollars; unless otherwise indicated)								
External public debt									
Total stock, including IMF	4,629	4,662	5,196	6,055	7,096	8,012	9,495	10,953	12,128
Present value (PV) of debt[3]	4,763	5,354	3,205	3,918	4,504	5,139	6,058	7,063	7,805
PV of debt (percent of exports of goods and services)	43.5	57.0	29.5	31.1	32.0	32.7	34.6	37.6	38.1
Scheduled debt service	160.0	181.7	194.6	189.3	330.0	366.5	403.1	341.3	317.3
Percent of exports of goods and services	1.5	1.9	1.8	1.5	2.3	2.3	2.3	1.8	1.5
Percent of government revenue	5.4	4.4	5.0	4.2	6.6	6.4	6.4	5.0	4.3
Exchange rate, (CGF per U.S. dollar)									
Period average	918	919	919	…	…	…	…	…	…
End-of-period	911	915	926	…	…	…	…	…	…
Memorandum item:									
Nominal GDP (CGF billions)[1]	21,913	25,250	27,596	30,390	33,939	38,094	42,838	48,132	53,469

Sources: Congolese authorities; and IMF staff estimates and projections.

[1] Starting in 2012 CPI numbers are calculated by INS using a revised methodology. The CPI for 2012 according to the previous methodolgy amounted to 5.7 percent (eop) and 9.3 (average).

[2] The projections for 2011 and beyond account for mining companies profit outflows.

[3] Projections are based on calculations under the 2010 HIPC Debt Sustainability Analysis (EBS/10/121, 06/16/2010). Includes assistance beyond the terms of the enhanced HIPC Initiative granted by some Paris Club creditors. Exports are a trailing three-year moving average.

the governance and accountability of the BCC. These steps, together with the rebuilding of the international reserves position and sustaining macroeconomic stability, are crucial for ensuring confidence in the Congo franc (CGF) over the long term. In this regard, the authorities' recent commitment to a (net) zero-central bank financing of the budget represents an important first step.

5. **Weaknesses in data and information gaps pose significant constraints on the team's stability analyses.** Efforts are needed to ensure the reliability of supervisory data, and to tighten the rules applying to re-classification and provisioning of loans, which mask at-risk loans' valuation and other latent risks. Auditing practices in the banking sector also need to be strengthened: access to qualified auditors would help enhance the quality of the financial institutions' balance sheets and facilitate banking supervision.

6. **An assessment of the anti-money laundering (AML) and combating the financing of terrorism (CFT) systems to determine compliance with the recommendations of the Financial Action Task Force (FATF) took place on March 18–27, 2014.** The mission identified important money laundering risks, with significant weaknesses in the area of supervision and control; the central bank does not have an adequate supervisory framework to assess the quality of the AML/CFT systems of banks and other financial institutions, and on-site inspections do not cover this AML/CFT. Large foreign exchange-related transactions, a buoyant domestic real estate market, and a very active informal economy operating in cash increase the risks.

FINANCIAL SECTOR STRUCTURE AND PERFORMANCE

7. **The Congolese financial system is shallow and underdeveloped.** The Congolese financial sector comprises 18 licensed banks; a state insurance company (SONAs) and the National Social Security Institute (INSS); 5 specialized institutions; 143 MFIs and cooperatives; 59 transfer institutions; 3 electronic money institutions, and 16 forex exchange bureaus. There is neither a stock market nor a debt capital market.

A. The Banking Sector and Financial Stability

8. **Banks account for the bulk of the financial sector** (Table 2 and Figure 1). Total bank assets, estimated at US$3.6 billion (about 13 percent of end-2012 GDP), represent about 95 percent of the total assets in the financial system. Bank deposits account for the bulk of total deposits (95 percent of the financial sector's deposits), with the balance being held in the MFIs. Four of the largest banks are local and another is controlled by foreign holding companies (with ties to Congolese interests). The sector is concentrated; by end-2012, the five largest banks held close to 65 percent of bank deposits and over 60 percent of total bank assets.

9. **Banks are highly dollarized and largely dependent on sight deposit funding.** Banks' funding is dominated by deposit collection—about 90 percent are in U.S. dollars and in sight deposit accounts. About 94 percent of loans are also in U.S. dollars as are 45 percent of overdrafts (less than one year). Clients are primarily companies with working capital deposits; loans target mainly daily operations and export/import activities. And deposit and lending rates are driven by

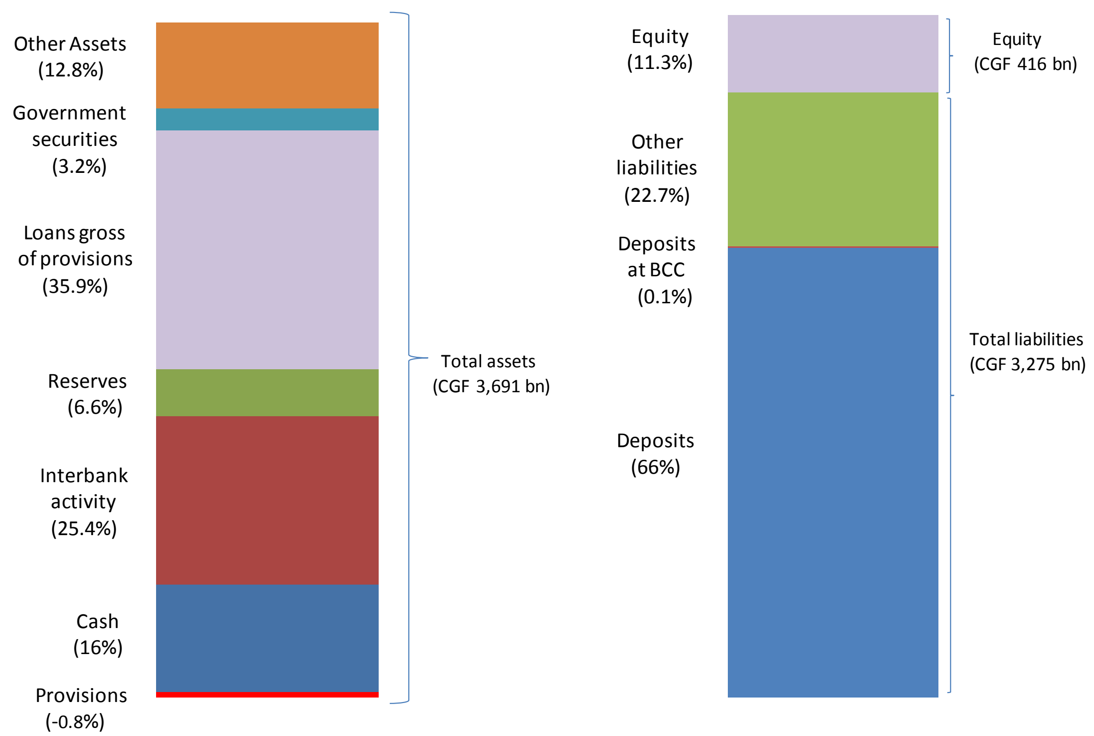
developments in global U.S. dollar markets, DRC country risk, and operational cost markups. The central and local governments hold significant balances in some banks (earmarked dollar deposits for investments) but also borrow funds from a few banks to finance administrative expenses.

Table 2. Democratic Republic of the Congo: Structure of the Banking System

	Number of Institutions	Branches	Assets: In millions of U.S. dollars	Assets: In Percent	Deposits: In millions of U.S. Dollars	Deposits: In Percent
Commercial Banks 1/	18	278	3624.6	94.7	2610.9	94.8
By size						
Top 5 Banks	5	...	2318.3	60.5	1785.3	64.8
Medium Banks	6	...	1004.3	26.2	700.9	25.4
Small Banks 2/	7	...	302.0	7.9	124.7	4.5
By ownership						
Domestic-Owned Banks	5	...	2072.4	54.1	1575.0	57.2
Foreign-Owned Banks	13	...	1552.2	40.5	1035.9	37.6
Non-Bank Financial Institutions	228	421	204.5	5.3	144.0	5.2
Insurance Companies	2	...	13.6	0.4	...	...
State Security/Pension fund 2/	1	...	...	...	...	...
Insurance Company 3/	1	...	13.6	0.4	...	...
Microfinance 4/	143	208	190.9	5.0	144	5.2
Cooperatives (COOPEC)	120	172	141	3.7	122.3	4.4
Microfinance Institutions	23	36	49.9	1.3	21.7	0.8
Deposit Taking	5	...	16.5	0.4	6.8	0.2
Non Deposit Taking 5/	19	...	33.4	0.9	14.9	0.5
Savings Fund	1	82	...	...	...	...
Specialized Financial Institutions	2	27	...	...	...	...
Finance Companies	2	2	...	...	...	...
Transfer Institutions	59	83	...	...	...	...
Electronic Money Institutions	3	3	...	...	...	...
Currency Exchanges	16	16	...	...	...	...
Total	**246**	**699**	**3829.1**	**100.0**	**2754.9**	**100.0**

Source: Central Bank of the Congo (BCC).
1/ As of December 2012. Based on audited financial statements.
2/ Assets less than $100 million.
2/ The pension fund operates more like a social security fund. It is funded through fees charged on salaries of existing workers.
3/ As of 2007. More recent data is not available. A monopoly insurance company established in 1966.
4/ As of end 2012.
5/ These institutions can only take compulsory deposits from their borrowers.

Figure 1. Democratic Republic of the Congo: Banking Systems Balance Sheet



Source: Congolose authorities; and IMF staff calculations.

10. Correspondent transactions with associated banks abroad are a significant share of banks' activities. These correspondent accounts represent over 25 percent of banks' assets and over 98 percent of the interbank market activity. They allow banks to conduct the settlement of USD-denominated transactions, reflecting efforts to hedge domestic political and settlement risks. These holdings of dollars in correspondent accounts are particularly expensive for depositors (zero remuneration and subject to high transactions costs).

11. Credit has been increasing fast but remains scarce, expensive, short-term, and highly concentrated. Between 2006 and 2013, domestic credit more than tripled but rose only to around 11 percent of GDP. In 2011, only 2 percent of adults had obtained a bank loan (with Sub-Sahara's average at 5 percent; World Bank's 2011 Findex survey), and only 4 percent of adults held an account at a formal financial institution (with Sub-Sahara's average at 24 percent; World Bank's 2011 Findex survey). Short-term credit (overdrafts and loans of less than two-year maturity) was about 68 percent of all credit at end-2012, and medium-term credit represented about 21 percent, an increase in the share from 16 percent in 2008. The five biggest borrowers of each bank received close to 30 percent of the credit extended at end-2012.

12. The banking sector remains weak, despite apparently high capital adequacy ratios (Figure 2 and Table 3). In particular:

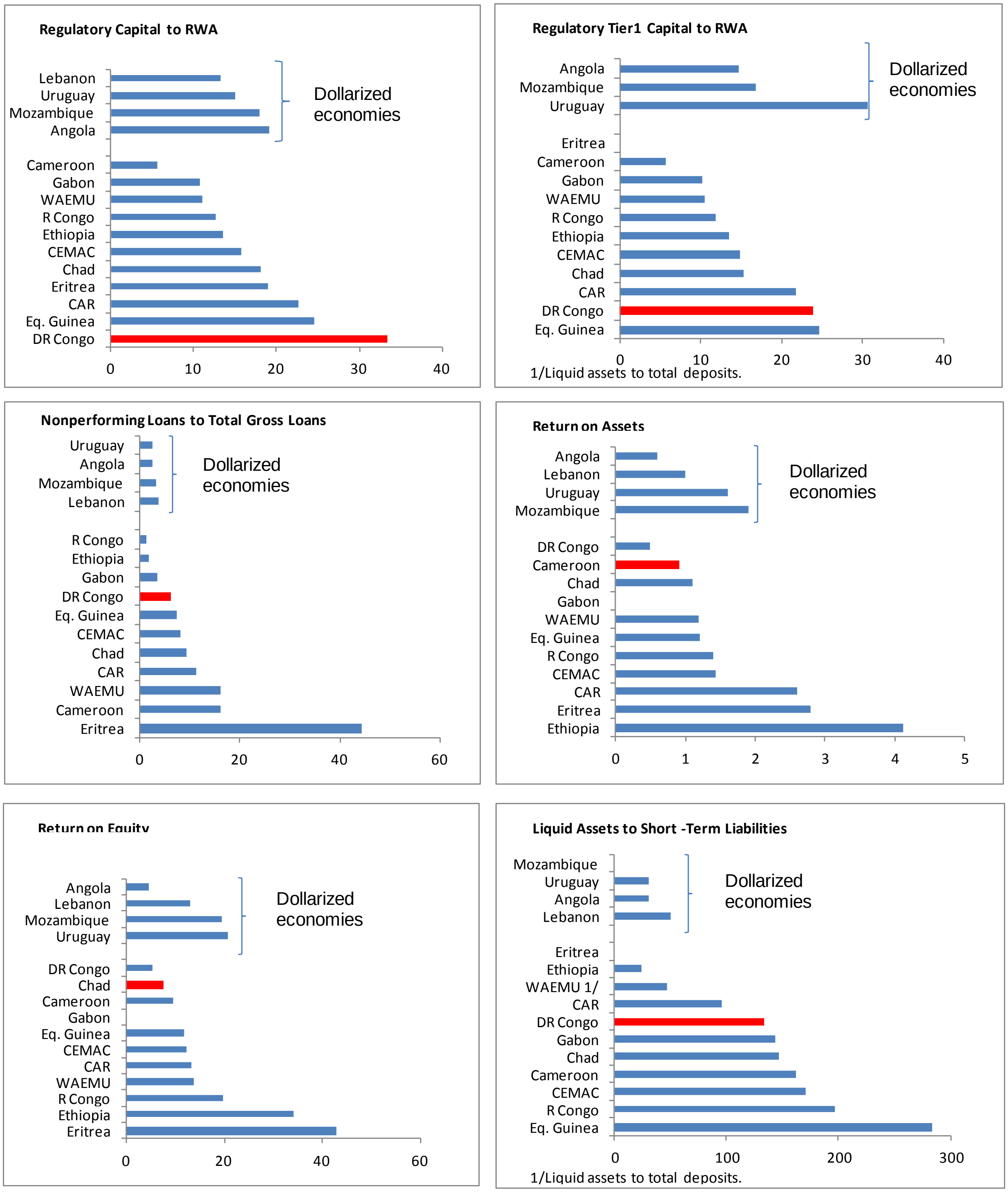
- The reliability of solvency and other financial soundness indicators is compromised by poor data quality, including because of weak application of international best practices for accounting definitions and methods. For example, end-2012 data for some banks show zero provisioning, balance sheet data reported to the central bank were inconsistent with audited statements, and low risk weights are applied on exposures to foreign correspondents' assets, claims on the state and central government agencies, and collateralized claims.

- Nonperforming loans (NPLs) statistics appear unreliable; under the BCC's regulatory framework, many banks are only recording unpaid balances rather than the full amount of the nonperforming loan.

- Analysis of banking trends is challenging given changes in reporting requirements and prudential norms, as well as the entry and exit of banks.

- Banks' profitability and earnings are weak and deteriorating, reflecting high operational and foreign exchange costs. Fees are a main source of banks' revenue. Operating in U.S. dollars is highly costly, especially for some banks, given foreign currency settlements are done via correspondents.

Figure 2. Democratic Republic of the Congo: Comparative Indicators of Banking System Soundness



Source: IMF, Financial Soundness Indicators database.

Table 3. Democratic Republic of the Congo: Financial Soundness Indicators, 2010–2013

	2010	2011	2012	2013
Capital adequacy				
Regulatory capital to risk-weighted assets	28.8	29.7	28.3	24.5
Regulatory Tier I capital to risk-weighted assets	21.1	21.2	19.9	17.0
Asset quality				
NPLs to gross loans	6.6	6.7	6.3	7.2
NPLs net of provision to capital	10.0	10.0	8.3	7.0
Earnings and profitability				
Return on assets	0.7	0.6	0.2	0.9
Return on equity	7.9	6.4	2.7	11.7
Interest margin to gross income	26.0	32.0	31.0	33.0
Non-interest expenses to gross income	73.7	73.5	73.1	73.9
Liquidity				
Liquid assets to total assets (liquid asset ratio)	60.0	52.0	…	…
Liquid assets to short-term liabilities	123.0	119.2	121.3	122.0
Sensitivity to market risk				
Net open in foreign exchange position to capital	-5.0	1.8	5.2	-16.0
Foreign currency-denominated liabilities to total liabilities	76.2	77.4	…	…
Memorandum items :				
Capital adequacy				
SSA	19.4	20.9	…	…
Fragile countries	24.3	34.7	…	…
Return on assets				
SSA	2.2	2.2	…	…
Fragile countries	1.7	1.0	…	…
NPLs to total gross loans				
SSA	9.8	8.4	…	…
Fragile countries	10.4	12.8	…	…

Source: Central Bank of the Congo (BCC), Directory of Bank Supervision.
Note: Prudential norms were altered throughout the observation period.

Table 4. Democratic Republic of the Congo: End-2012 Banks' Income Statements

Expenditure	Total	Domestic Banks	Foreign Banks	Revenue (In percent)	Total	Domestic Banks	Foreign Banks
Total (CGF billion)	457	230	227	Total (CGF billion)	465	246	218
Expenditure shares (In percent)				*Revenue shares (In percent)*			
Bank operating expenses (foreign exchange transaction costs)	17.0	12.3	21.8	Bank revenue from interests (loans, overdrafts)	40.8	40.5	41.1
Other expenses (overheads, staff)	78.9	82.2	75.6	Bank revenue from commissions and exchange rate	41.1	37.9	44.7
Income tax	4.1	5.5	2.7	Other income	18.1	21.6	14.2

Source: Central Bank of the Congo (BCC).

B. The Nonbanking Sector and Financial Stability

13. The microfinance sector has been growing rapidly since 2001, but remains undeveloped.[2] By end-September 2013, the size of the microfinance sector's balance sheet was close to US$222 million with over a million accounts opened; savings and loan cooperatives accounted for 60 percent of the accounts and MFIs for the remaining 40 percent. Most of the primary savings and loan cooperatives (COOPECS) and MFIs operations are concentrated in the eastern part of the country. They operate under BCC regulation, with licenses being granted by the BCC, and the regulatory and prudential norms also being set by the Central Bank.

14. The microfinance sector's business model has largely focused on savings and loan services. Between end-2009 and June 2013 deposits and loans more than doubled (to US$144 million in deposits and to US$113 million in loans), a similar trend to that of banks. Both deposits and loans are also mostly in U.S. dollars, and activity remains highly concentrated: the two microfinance institutions specialized in loans to micro, small, and medium-sized enterprises (MSMEs) account for 51 percent of deposits and 42 percent of the credit of the entire microfinance sector.

[2] Savings and loan cooperatives have existed for a long time in the Democratic Republic of the Congo; however, many failed during the crisis years (the 1990s).

15. The microfinance sector has great potential to support financial inclusion, but it is underperforming (Table 5). Profitability in the sector is very weak with only two institutions, accounting for 3 percent of the assets, being operationally self-sufficient by end-June 2013. Institutions with negative profits or negative equity accounted for 18 percent and 9 percent of the sector assets, respectively. Operational and financial difficulties affecting some COOPECs are linked to serious governance, financial management, and internal audit deficiencies. Also, by end-March 2013, 37 largely inactive institutions were put under involuntary liquidation status (34 COOPECs and 3 MFIs) and, by end-August 2013 63 licenses had been withdrawn. By end-December 2013, eight out of the 23 MFIs faced difficulties in raising capital levels to the minimum required levels. The analysis of the sector points to the need for its consolidation and the strengthening of supervision. Also, the National Microfinance Fund, a government's initiative aiming at integrating vulnerable population into the financial sector with a US$2.5 million budget, has not yet started operations.

Table 5. Democratic Republic of the Congo: Number of Microfinance Institutions Not Meeting the Regulatory Norms

Key indicators	June 2013
Prudential indicators	
Solvency ratio	13
Liquidity ratio	2
Profitability indicator	
Operating revenues to operating expenses ratio	34
Operational expenses to the average gross loan portfolio	15
Return on equity	27
Return on assets	18
Capital levels	
Capitalization	30
Total number of institutions surveyed	36
Source: BCC.	

16. The sole public non-life insurance company, SONAS, and the National Social Security Institute (INSS) are both in precarious financial situations.

- **SONAS is a public non-life insurance monopoly with 2,165 employees and a broad network**. It is not currently able to meet the government's mandatory insurance obligations (automobile liability, sea, river, and air transportation, and fires for certain buildings).[3] The company does not produce reliable financial statements; an audit undertaken by an international firm in 2012 identified a capital shortfall of about US$211 million, as well as numerous operational weaknesses. Legislation is planned to open the insurance market to foreign entrants, however. The future of SONAS and the fiscal cost that would arise from its liquidation or restructuring needs to be evaluated.

- **INSS offers very limited coverage (less than 1.6 percent of the active labor force), management costs absorb the bulk of the social security contributions, which are one of the highest in Africa (7 percent of wages for pensions)**. The INSS operates through a decentralized model of 45 centers with important weaknesses in organization,

[3] A number of businesses signed for insurance services abroad after paying for mandatory premiums due to the limited capacity of SONAS to deliver.

computerization, and supervision capacity. End-June 2013 estimates point to important fragilities in the medium term, with a shortfall in contributions to obligations of CGF 23.8 billion in 2015 (about 0.1 percent of 2013 GDP) and of CGF 229 billion in 2060 (1.4 percent of 2013 GDP). The actuarial liability of the social security system is estimated at 28.3 percent of 2013 GDP. Strengthening the current system would require prompt action to streamline costs and significantly increase contributions.

17. The effectiveness of the CADECO, SOFIDE, and PFI is limited and they pose significant fiscal risks, mostly because of governance weaknesses, pointing to the urgent need for restructuring (or liquidation).

- **CADECO is a state-owned enterprise that provides financial services in rural areas. It handles the payment of CGF 146 billion in wages and CGF 47 billion in taxes of public enterprises' employees (2012 figures).**[4] The company is undergoing a restructuring but risks persist and progress has been lagging. CADECO's financial statements are unreliable, deposits remain non-accessible, and it does not have access to the BCC clearing house since 1996.

- **SOFIDE is the financial development company with a large state ownership stake with a mandate to promote the medium- and long-term financing of small and medium-sized Enterprises (SMEs).**[5] As part of its efforts to enhance SME financing in 2012, the government injected US$22 million in capital, and some additional US$40 million is expected in the near future. By end-September 2013, SOFIDE had funded about 63 SME projects for US$20 million with three-month to three and a half-year collateralized loans at 15 percent interest. Oversight mechanisms are weak and SOFIDE lacks of proper risk management controls; an independent review of its financial situation is needed. Some form of collaboration with the banking system to reinforce SME financing could also foster effectiveness.

- **The FPI is the fund established in 1989 to promote and finance industrial projects. Its resources draw from import taxes (about US$72 million per year from a 3 percent tax on imports).** It grants loans to the agro-industry mainly with three to five year maturity at 8–10 percent interest, and a 12-month grace period. The fund is not under BCC supervision, its financial statements are unreliable, and it lacks risk management and auditing tools. A 2010 internal portfolio restructuring commission undertaking the asset quality review of the portfolio has not been able to complete the task as yet; first estimates point to over 40 percent of the end-2012 outstanding loans (US$233 million) is in arrears.

---

[4] It operates through its 93 operating centers in the country and its 669 employees. It also provides salary advances to its customers (CGF 4.8 billion by end-2012) at monthly rates of 5–10 percent interest for 6 months maximum. In 2012, NPLs from the government reached US$46 million and the year results improved only because of a questionable reversal of US$29 million in provisions.

[5] Its activities had been suspended between 1990 and 2012 after international assistance had ceased; its only revenue derived from the rental of its property assets and the granting of 3–6 month loans under a US$1.5 million portfolio.

RISKS AND RESILIENCE OF THE BANKING SECTOR

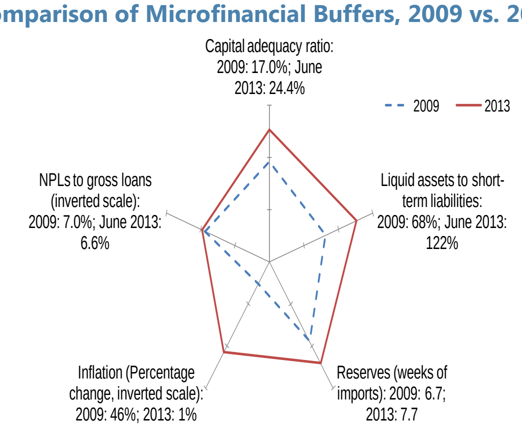
A. Financial Sector Vulnerabilities

18. The Congolese banking system remains fragile even though, to date, it has proved (largely) resilient. The Democratic Republic of the Congo faces three main sources of vulnerabilities (Table 6): external (a surge in food prices/slump in raw material prices and/or slower global growth); fiscal (budgetary slippages); and/or a loss in confidence (because of security concerns, political instability, disruptive de-dollarization process). A sharp drop in commodity prices could have a significant impact on the economic growth and public finances and, as a result, on the exchange rate and inflation, as had been the case during the crisis in 2009. The monetization of the deficit would, as in the past, re-introduce price volatility and inflationary pressures, reinforcing the dollarization of the economy.

19. Dollarization also represents an important vulnerability for the banking sector. As noted above, required reserves and other regulatory requirements are defined in domestic currency terms, deposits are largely dollar denominated and short-term in nature, and the BCC has only very limited capacity to provide dollar liquidity in the event that funding pressures emerge.[6] Conversely, the authorities plan to promote de-dollarization will need to be carefully sequenced and communicated to the public to minimize the potential for market disruption. For example, it will be important to ensure that steps to discourage dollar transactions do not trigger a flight of dollar deposits and that dollar buffers are adequate.

20. The 2009 banking crisis episode illustrates that commodity price shocks quickly affect bank balance sheets and the macroeconomic outlook (Figure 3). A decline in world commodity prices would lower mining production and investments, and impact other economic sectors depending on the mining sector, and reduce these sectors' ability to service their banks' debt. It would also affect fiscal revenues and possibly push the government try to stimulate the economy and monetize the higher deficit which, as seen in the past, would fuel the depreciation of the CGF.

Figure 3. Democratic Republic of the Congo: Comparison of Microfinancial Buffers, 2009 vs. 2013



Source: IMF staff estimates.

[6] On March 14, 2014 the monetary authority approved new coefficients for required reserves that would vary depending on maturity and currency of denomination. Foreign exchange denominated deposits are now subject to an 8 percent reserve requirement if held in sight deposit accounts (7 percent for those held in domestic currency) and 7 percent if held in longer term deposit accounts (3 percent for those held in domestic currency).

21. In addition, several banks have large exposures to the same industrial companies. The failure of one of the companies could spill over simultaneously into different financial institutions. Concerns on this front are mitigated, somewhat, by the limited interbank exposures, which sheltered the system from contagion during the period when the Banque Congolaise (BC) (Appendix III), a very large bank, failed and had to enter into the liquidation process (2009/2010).

Table 6. Democratic Republic of the Congo: Risk Assessment Matrix

(Scale—high, medium, low)

Source of Risk	Relative Probability	Impact if Risk Materializes
Protracted period of slower growth in Europe and emerging markets (China in particular), with the intensification of crisis in the euro zone.	Medium The DRC's exposure to Europe is limited. The impact would be indirect through its impact on the DRC's trading partners' growth and commodity prices.	Higher current account deficit and slower accumulation of international reserves. Deterioration in the portfolio quality of the commercial banks and MFIs. Reduction in direct investments in natural resources and increased pressure on public finances.
Budgetary slippages	High If revenue projections do not materialize, there is a risk of increased deficits. In the absence of public debt instruments, these deficits would require central bank financing, fueling inflation and putting pressure on the value of the CGF.	Depreciation of the nominal exchange rate would adversely affect banks' balance sheets. A loss of confidence in macroeconomic policies could result in a reduction in bank deposits. In a dollarized economy, the central bank has limited options for responding to bank liquidity pressures. An increase in NPLs.
Sustained decline in commodity prices, triggered by a deceleration of global demand	Medium A slump in mineral (cooper) export prices would lead to a drop in the mining sector production with growth and fiscal implications, drop in international reserves and foreign exchange pressures.	A 2 standard deviation decline in copper prices compared to the historical average could lead to a 4 percent reduction of real GDP during the first post-shock year 2014, to a deterioration of the current account deficit of 16 percent of GDP, and currency depreciation of about 38 percent. With bank balances highly dollarized, the depreciation of the domestic currency could precipitate deposit flight.
Loss of confidence due to security concerns, political instability and/or disorderly de-dollarization process.	Medium/Low Changed sentiments could have repercussions for the rest of the economy and lead to a decline in capital inflows and possible deterioration of budgetary accounts.	Deposit run in the absence of a backstopping facility able to credibly reduce pressures. Insufficient international reserves at the BCC could exacerbate the run on deposits and lead to a systemic crisis.

B. Banking Sector Resilience

22. Banks' balance sheets suggest a number of vulnerabilities. Direct currency-related risks stem from heavily dollar-denominated balance sheets that are not backed by dollar-denominated reserves and other prudential requirements, while indirect currency risks stem from the fact that borrowers are inadequately hedged. In addition, funding and loan concentration is high and short-term.

23. Tests were undertaken to assess the resilience of the banking sector to the types of shocks experienced in 2009 (Appendix V)**.** The stress tests covered all active banks, representing 95 percent of the financial sector assets. Solvency and liquidity tests followed a bottom-up approach using end-2012 audited balance sheet data.[7] Banks' capital needs were assessed against the domestic regulatory requirements (10 percent of risk-weighted assets). The exchange rate shocks, in particular, were designed to mimic the 2009 episode, when plummeting commodity prices caused a large loss of international reserves. Also, the tests also looked at the resiliency of the system to fiscal slippages and to a sudden drop of confidence and a deposit run.

24. The stress test results need to be interpreted with caution, especially given data quality concerns, and suggest areas where the authorities could improve their own risk monitoring**.** A specialized unit, responsible for enhancing supervision data, its analysis, and performing stress tests within the Directorate for the Supervision of the Financial Intermediaries (DSIF), is urgently needed. In the context of the government-led de-dollarization process and a vulnerable financial system—plagued with weaknesses in the financial supervisory and regulatory frameworks—an effective reinforcement of the DSIF' monitoring capacity (with qualified experts) and periodic banks' stress test analyses would permit identify financial stability pressures, and, for instance, identify mismatches in bank's balance sheets in a timely manner.

C. Credit Risk

25. The solvency stress tests suggest that the banking sector is vulnerable to credit risk derived from exchange rate depreciation. Solvency stress tests were based on sensitivity analysis of single and multi-factor shocks, using end-2012 as the baseline (see Appendix V). One scenario focused on a commodity price plunge and a second scenario on the effects of a deterioration of the fiscal outlook. The commodity price shock scenario assumed that copper prices dropped by 40 percent, the exchange rate depreciated by 55 percent in domestic currency terms (as occurred in 2009). In addition, tests were run to assess the implications of (i) defaults by the top two obligors of each bank; (ii) a 50 percent increase in NPLs; and (iii) a shock in the mining sector leading to the full

[7] The stress tests were conducted using end-2012 bank by bank audited data available at the time of the FSAP mission. Subsequently, the authorities provided data that they had adjusted using more granular supervisory data of the same source and vintage. Staff has not had opportunity to discuss the nature of these adjustments nor assess the quality of this adjusted data. The new adjusted data, prime face, do not appear to materially affect the conclusions of the stress tests.

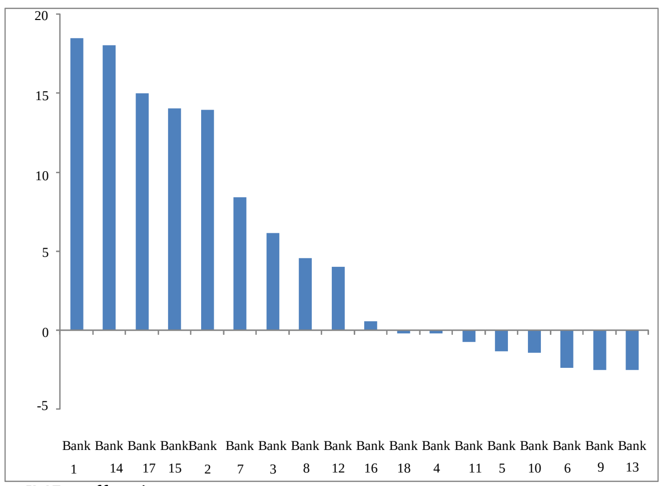
provisioning of the additional NPLs in the sector. The fiscal slippage scenario assumed a 50 percent default on loans granted to the public sector.

26. The commodity price plunge scenario indicated that the banks are most exposed to a sudden exchange rate depreciation (Table 7). The loss of CGF value would particularly affect unhegded borrowers, with loans in U.S. dollars but revenues in local currency, but also significantly reduce the provisions and capital position of the banks. The exercise considered first that borrowers would not be able to pay the additional costs caused by the depreciation; a second exercise assumed the full default of 20 percent of all borrowers, which further exacerbated the banks' capital needs.

- **A sudden steep depreciation of the exchange rate would harm borrowers' ability to repay their loans, increase provisions significantly and capital needs for a number of banks** (Figure 4). In this case, the capital adequacy ratio (CAR) for the entire banking system would decline to 3.6 percent and gross NPLs increase to about 15.4 percent. In the depreciation scenario, the capital shortfall—the minimum capital needed to bring each bank's capital ratio to at least regulatory minima—would be slightly above 0.6 percent of GDP under the first exercise and 1.2 percent of GDP when assuming default as in the second exercise. The amounts are relatively small largely due to the small size of the sector relative to the economy.

Figure 4. Democratic Republic of the Congo: Estimated Banks' Capital Needs if the Exchange Rate Depreciates Sharply

(in CGF billions, individual banks' 1 to 18 using end-2012 audited data)



Source: IMF staff estimates.

- **The impact would be more significant for large- and medium-sized banks than for small banks;[8] the capital adequacy for large banks would fall to 1.8 percent.** Small banks would be insulated because of their very limited lending activity.

[8] Large banks are those with assets exceeding CGF 300 billion; medium-sized banks assets have CGF 100 billion in assets; and small banks have assets less than CGF 100 billion.

Table 7. Democratic Republic of the Congo: Solvency and Liquidity Stress Tests 1/
(As of end-December 2012; in percent except indicated otherwise)

	Local banks	Foreign banks	Large banks	Medium-sized banks	Small banks	Total
Baseline: CAR before the shock	**25.4**	**31.5**	**24.3**	**25.8**	**57.4**	**28.1**
CAR after shocks						
Scenario: Commodity prices plunge						
Credit Risk						
Default of largest borrower	17.7	19.8	16.6	12.3	51.6	18.6
Default of second largest borrower	22.8	19.2	21.6	19.4	30.0	21.3
Increase of 50% of total non-performing loans	23.7	27.5	22.5	23.7	50.1	25.3
Sectoral shock: Mining	25.3	31.3	24.2	25.7	57.2	27.9
Indirect credit risk from foreign exchange 2/						
In case of partial default (as a share of depreciation)	2.3	5.3	1.8	3.4	14.8	3.6
In case of full default of 20 percent of borrowers	-5.5	-0.3	-6.4	-2.6	12.6	-3.2
Indirect credit risk from foreign exchange 3/						
Increase in legal reserve requirement due to currency depreciation	13.5	18.6	12.7	14.1	38.9	15.7
Liquidity risk *(Number of banks illiquid)*	Day 1	Day 2	Day 3	Day 4	Day 5	
Withdrawal of deposits 4/						
Local banks	0	0	0	0	2	
Foreign banks	1	1	4	4	5	
Large banks	0	0	0	0	2	
Medium-sized banks	1	1	4	4	5	
Small banks	0	0	0	0	0	
Total Banks	1	1	4	4	7	
Scenario: Budgetary slippage						
Credit Risk						
50% default of loans to public sector	21.3	27.0	20.0	22.8	50.7	23.8
Liquidity risk *(Number of banks illiquid)*						
Withdrawal of deposits from the public sector	25 percent	50 percent				
Local banks	0	0				
Foreign banks	0	2				
Large banks	0	0				
Medium-sized banks	0	2				
Small banks	0	0				
Total Banks	0	2				

Source: BCC; and IMF staff estimates.

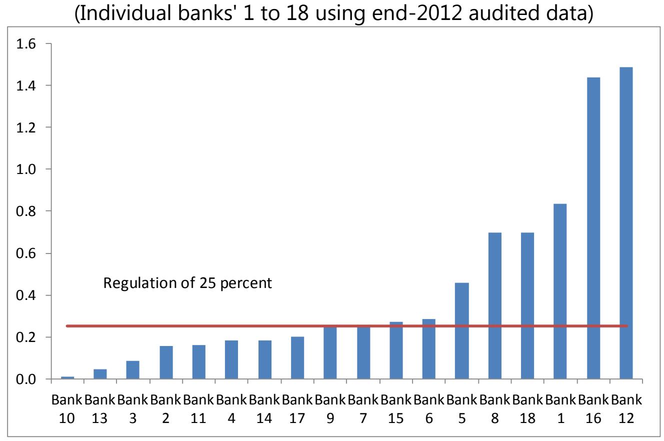
1/ 2013 data were not available at the time of the mission.
2/ Scenario: 55 percent depreciation of the national currency against the U.S. dollar: 20 percent of borrowers have revenues in local currency with dollar loans; tier 1 capital held in local currency.
3/ Scenario: 55 percent of local currency depreciation against U.S. dollar: every month, each bank is required to adjust its legal reserve as 7 percent of total deposit in local currency based on changes in U.S. dollar total deposit.
4/ 10 percent daily withdrawal for banks with large exposure to copper sector/6 percent daily withdrawal for the rest of banks.

- **And, for both domestic and foreign banks, the average capital adequacy ratio (CAR) would decline to 2.3 percent and 5.5 percent, respectively.**[9]

- **The stress tests also identified vulnerabilities resulting from credit concentration.** BCC regulations limit simple individual loan exposures to 25 percent of regulatory capital, however, some banks seem to violate this requirement (Figure 5). In the scenario of a commodity price drop, default on payment by the largest borrower would have a considerable impact on the banking system, reducing the CAR by 9.5 percentage points to 18.6 percent, with three banks falling below the 10 percent minimum. Foreign banks and medium-sized banks are most exposed, with the capital shortfall equivalent to ¼ percent of GDP. This test also found that default by the largest borrowers would potentially have systemic effects on the entire banking system, given that most banks share the same five major borrowers in their portfolios.

Figure 5. Democratic Republic of the Congo: Large Concentration Exposures

(Individual banks' 1 to 18 using end-2012 audited data)



Source: IMF staff estimates.

27. A deterioration of the fiscal situation, similar to that experienced in 2009, would also have implications for two banks. A fiscal shock is likely to translate into monetization of the deficit and a weakening of the exchange rate, especially given the low level of international reserves. Furthermore, the central government and other public sector entities are major clients for some banks, both on deposits (largely earmarked for projects) and loans to fund public administration expenses. In this scenario, a domestic bank and a foreign bank, with large exposures to the government, would see their CAR fall below the minimum requirement.

D. Liquidity Risk

28. The banking system is highly vulnerable to liquidity shocks. The exercise simulated the implications of dollar-denominated deposits run on banks caused by a loss in confidence in the economy. The tests were calibrated with reference to the changes in the deposits between June 2008 and June 2009 and assumed (i) a 10 percent of deposits drop on a daily basis for banks with large exposures to the mining sector and (ii) 6 percent of deposits decline on a daily basis for the rest of banks for five business days. The analysis considered "cash and deposits at the BCC" as liquid assets, but not liquid in the correspondent accounts.

[9] There are five domestic private banks accounting for 54 percent of banks' assets; and 13 foreign banks (owned by banks or individual outside the DRC) with the remaining 41 percent of the banking sector assets.

29. Foreign banks and medium-sized banks are most exposed to liquidity shocks. By day five, seven banks would become illiquid, two large local banks and five foreign banks. And, assuming a rapid depletion of public sector deposits, fueled by government's liquidity problems, two foreign banks would be particularly affected given their large public sector deposit balances.

E. Interbank Contagion Risk

30. The national interbank market does not appear to pose direct systemic risks. The market is limited in terms of the size of transactions and individual bank exposures are very small if any.

FINANCIAL SECTOR SUPERVISION AND REGULATORY FRAMEWORK

31. In the past years, the BCC has made significant efforts to improve the prudential framework and its supervisory work, but still faces major challenges. Key difficulties are associated with the application of a compliance- rather than a risk-based supervision approach to supervision (Appendix IV); the lack of coordination within the DSIF; the lack of clarity in the legislative and regulatory mechanisms; the BCC's lack of a financial stability function with corresponding powers; and insufficient technical capacity.

32. The legislative and regulatory mechanisms lack clarity, and the supervisory authority does not have the proper mandate for preserving financial stability. The law, often inaccurately known as banking law, applies to all credit institutions[10] defined as financial sector enterprises that carry out banking operations. These include banks, savings and loans companies, MFIs, specialized financial institutions, and financial companies. However, some of these institutional categories also operate under separate legislation. The BCC's legal mandate does not include preserving financial stability, which helps explain the absence of BCC's focus and analyses on financial stability.

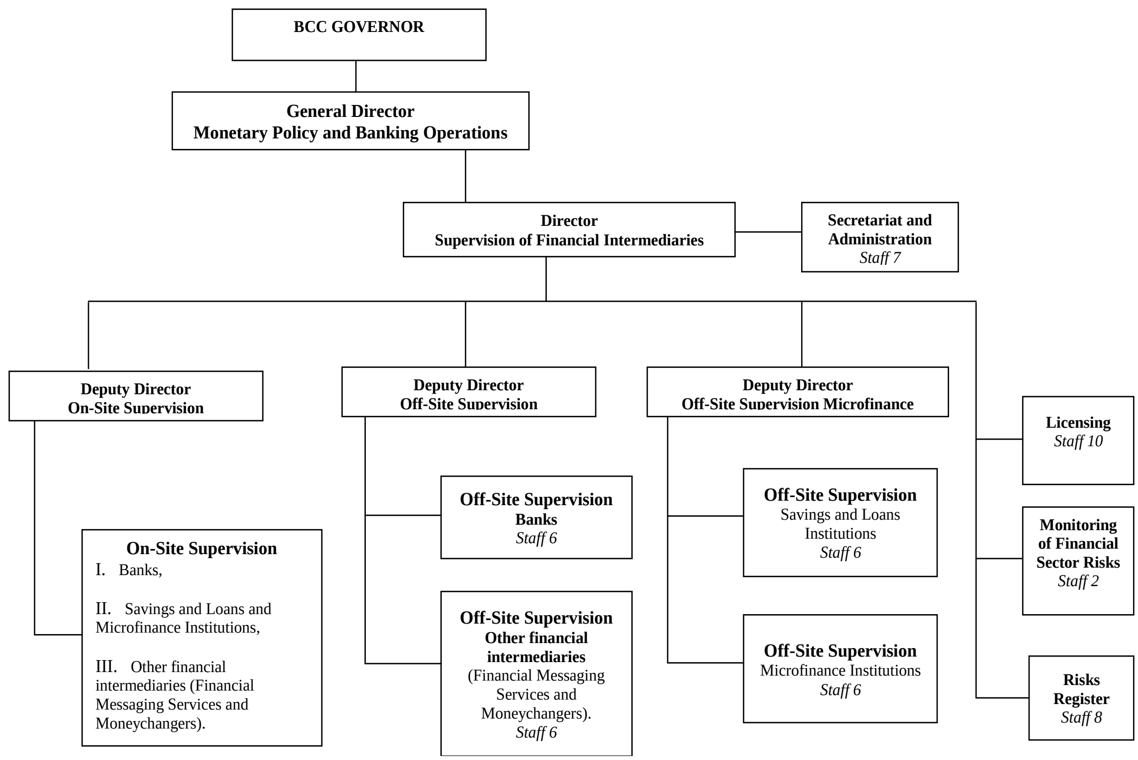
33. The passing of the proposed BCC law and the banking law is an urgent priority.[11] The new banking law is expected to strengthen the tools to enforce prudential norms and powers to liquidate failed banks. The BCC law is also expected to clarify responsibilities and mandates on banking supervision, financial stability, and resolution, and provide proper enforcement tools. This new legislation should help improve the independence of the BCC and avoid political interference, which in the past led to the suspension of supervisory decisions. Both pieces of legislation are key measures in addressing financial stability risks.

[10] From a regulatory and supervisory standpoint (Law No. 003-2002, Law No. 002-2002, and Law No. 2011/020) the microfinance sector is under the oversight of the BCC.

[11] Both pieces have benefitted from important technical assistance support of the IMF Legal Department (LEG).

34. Despite a recent reorganization, there is not enough cooperation among the DSIF's three principal functions: licensing, ongoing control, and on-site supervision (Figure 6). This lack of synergy among the units of the DSIF at the operational level, combined with the lack of well-documented procedures, guidelines, and risk assessment tools in each of the three sectors, has impeded the BCC from effectively fulfilling its tasks. In this context, improving the reliability of data received from institutions, as well as their processing by the central bank, are necessary preconditions to strengthen supervision.

Figure 6. Democratic Republic of the Congo: Supervisory Structure



Source: BCC; and IMF staff estimates.

35. Stepping up prudential monitoring will also require improvements in data. For supervisors to be able to systematically understand the risks that institutions bear there is a need for an in-depth review of the prudential information received by the central bank, especially on those requirements related to risks (concentration, liquidity, and interest rate) monitoring. And, while off-site supervision should effectively conduct an in-depth review of prudential or regulatory information received from affected institutions, on-site inspections should be more systematic, regular, and cover all institutions, including MFIs.

36. The Central Bank's use of its supervisory powers remains limited, and the application of the existing regulatory framework is not sufficiently stringent. A number of banks have been systematically breaching the minimum regulatory requirements with only financial penalties applied; licensing requirements have been relaxed in order to facilitate financial inclusion; the BCC appears not to be fully aware of the identity of the principal shareholders of several banks (notably of holding companies), limiting its ability to restrict connected lending. And, the BCC lacks financial autonomy, leaving it dependent on the treasury. In several cases where the interests of the state and the responsibilities of the BCC in its supervisory capacity diverged, the BCC opted for not taking the actions prescribed under its mandate; the licensing of La Cruche Bank and the liquidation of the Banque Congolaise are two recent examples.

37. The BCC's supervisory approach relies on checks on compliance with laws and regulations. In the absence of a well-structured regulatory framework, the updating of the banking regulations in line with international standards, has been slow. The regulatory mechanism does not incorporate a number of Basel Committee standards and good practices that constitute the basis of risk-based supervision (e.g., classification and provisioning of loans, monitoring of loans to related parties, principles of risk (interest, liquidity and operational), business continuity plans, lack of powers to reject non-endorsed central bank transfers of control in banks. The ongoing revisions of the banking law and of the central bank's statutes would be a good opportunity to harmonize the current legal framework, which is the result of an accumulation of successive texts.

38. There is a need for developing preventive mechanisms ahead of restructurings or orderly resolutions. There are no provisions requiring systemically important credit institutions, to submit preventive restructuring plans identifying corrective measures to cope with a sharp deterioration in their financial situation and restore their viability. In the absence of any other resolution authority, the law does not give the BCC clear powers to decide if a bank should be subjected to orderly resolution. Without tools that would allow the DSIF to identify credit institutions' risks profiles and systemic institutions, the DSIF has not set up any internal mechanism that would allow for the adoption of preventive resolution plans.

39. The technical capacity and organization of the supervisory body needs to be substantially reinforced. There is a significant shortfall in expertise and skills needed to enable the DSIF to adequately implement its supervisory mandate. Also, current working methods, the organization of supervision, and incentive mechanisms need to be significantly revised. The current framework does not include provisions to deal with conflict of interest prevention, integrity issues, or to ensure the legal protection of the BCC and its staff against potential legal action for acts and omissions they carry out in good faith in the exercise of their bank supervision functions or for adequate coverage for legal costs potentially incurred for their defense.

40. The current sanctioning powers are exclusively monetary, which undermines the supervisor's authority. In practice, the BCC is not using the entire range of sanctions it has at its disposal. For instance, instead of sending injunctions (or warnings) to troubled credit institutions the BCC is attaching disciplinary sanctions to the injunctions, a profitable practice that generates income to the BCC, but goes against the very purpose of the injunction. Furthermore, some institutions in critical situation received successive injunctions over long periods of time without further actions taking place. In addition to the existing sanctioning powers, there would be a need to extend the BCC sanctioning powers against troubled institutions to allow, for instance, stricter prudential limits (or requirements), to prohibit undertaking new activities or acquisitions, restrict or suspend payments to shareholders, restrict asset transfers, replace directors or controlling shareholders or limit their prerogatives.

41. There is some progress in the cooperation between home and host supervisors, but more is needed. The BCC is participating in several regional groups of supervisors, as general cooperation, but also working in a number of memorandums of understanding (MOU) with home supervisors to cover specific banks' activities. Participation in regional groups is important to improve mutual understanding of the application of standards, particularly in the area of minimum capital and equity requirements, and on the introduction of Basel II, particularly pillars two and three. Additional efforts to set up an effective information sharing system, combined with a reciprocal understanding of the activities and risks of institutions operating in different jurisdictions, would improve the process of prudential supervision and contribute to saving resources.

42. A detailed prudential regime for microfinance activities was just passed in 2013, but more is needed. This new legislation doubles the minimum capital (US$350,000 (2013)) to (US$700,000 (2017)) of microfinance companies taking public savings, and also strengthens the sector's prudential standards, loan classification and provisioning, and performance indicators. The 2012 Accounting Plan for Savings and Loan Cooperatives and Microfinance Institutions is a step forward but more is needed. The DSIF needs further resources[12] to focus not only on the largest institutions (i.e., 36 main institutions). Going forward, the agency intends to focus on the umbrella organizations of savings and loan cooperatives and, under law 002/2002 and Directive 11 of January 18, 2013, apply the principle of delegated supervision.

CRISIS MANAGEMENT AND SAFETY NETS

A. Crisis Preparedness

43. The BCC needs to bolster its framework to deal with a possible generalized crisis in the banking system or even of an individual bank. The prudential framework needs to be re-directed toward a risk-based approach where supervision functions not only look into past practices but into identifying and analyzing new emerging risks with a view to preserve financial stability. These risks could emerge from changes in the commercial development strategy, operations with parent companies or affiliated foreign companies, exposures to related parties, and overly rapid growth of loans.

44. Furthermore, coordination between the BCC and the MOF, and with other supervisors, should be strengthened. Better coordination requires a clear definition of the roles, functions and responsibilities in dealing with a crisis. In the current framework, the role and accountability of the BCC to intervene a troubled institution remains unclear. Also, the relevant authorities should consider "war games," simulating plausible crisis scenarios, building on the identification of the

[12] Microfinance supervision is conducted by the Microfinance Off-Site Supervision Division, which includes the unit in charge of supervising savings and loan cooperatives (with 12 inspectors) and a unit supervising MFIs.

systemically important institutions, to enable the preparation of crisis management action plans and operational procedures, and to test the adequacy of backstop liquidity facilities and access to public funds. These efforts would also benefit from a proactive and regular consultative approach with the country-of-origin supervisors of foreign banks.

B. Responding to a Crisis

45. The BCC's capacity to act as the lender of last resort is very constrained. In the current dollarized environment and very limited U.S. dollar reserves, the scope for direct official financial support to respond to U.S. dollar funding pressures is very limited. The legislative and regulatory framework needs to be updated to allow for a limited use of official financial support to protect CGF-denominated depositors only if certain conditions are met. These conditions would include burden-sharing mechanisms assigning losses to former shareholders, mechanisms for the government to exercise its voting rights, mechanisms for informing the public and parliament, among others.

46. The framework for orderly and effective resolution needs to be strengthened to allow for swift responses that maximize recovery value and minimize fiscal costs. In past cases of involuntary liquidations, implementation of central bank decisions have been delayed owing to court challenges by former shareholders or suspended following external interventions. Since 1998, the BCC has initiated liquidation processes on 11 banks: 9 of them on a mandatory basis (ATB, BANCOR, BCA, BCCE, BCD, COBAC, FBCC, and Banque Congolaise) and 3 of them on a voluntarily basis (BANCOC, UBC, and Mining Bank). Weaknesses in the environment and interference have introduced significant delays in the processes and increased their fiscal costs. For example, in the past two and a half years, only 3–4 percent of the remaining BC assets have been liquidated.

47. Furthermore, liquidation powers need to be strengthened. The legislative framework needs to strengthen the central bank's intervention powers and to better define the respective roles of the Central Bank and the liquidator during the course of the liquidation process (Appendix III). Currently, the liquidator's terms of reference do not provide decision authority on the liquidation of a failed bank. The liquidator does a periodic and relatively informal reporting that is rarely challenged by the BCC and its Committee on the Coordination of Bank Liquidation Operations (an extension of the DSIF), and submit all his management actions to the prior approval of the central bank before acting. The ex-ante BCC clearance requirement in each step of the liquidation process is associated with long delays, a significant loss in value of remaining assets and further costs to the state. Under a new framework, the BCC would be required to respond within pre-determined deadlines with the understanding that no reply would mean automatic approval. Then, the BCC would conduct an in depth a posteriori control of the supervisors' actions in the liquidation process. This new mechanism could also facilitate liquidators adjusting the bank's balance sheet to cover mark-to-market valuation, up-to-date account balances, and lead to a prompt recognition of losses.

C. Deposit Insurance

48. A number of conditions need to be in place before a limited deposit guarantee scheme for CGF-denominated deposits could be established.[13] An explicit deposit insurance scheme would not appear feasible presently considering the limited resources of the state. Moreover, supervision and regulation appear insufficient to limit the potential moral hazards, especially in light of the results of the assessment of the system against the BCPs, governance and transparency gaps, and weaknesses in the quality of financial and accounting data. In addition, important design issues would need to be carefully considered first, including with regard to the coverage of dollar deposits, the coverage of MFIs, the size of the guarantee, etc.

DEVELOPMENT AND MARKET STRUCTURE

49. Credit is constrained by the current business/legal environment, the banks' funding models and the cost of credit. Small and medium-sized companies with access to credit are less than 50 percent of the average in the Sub-Saharan region according to the 2010 World Bank Enterprise Survey.

- **A difficult business environment with an uncertain application of the rule of law combines with the lack of diversification of the economy, limiting potential demand for financial services**.[14] Other important stumbling blocks include the perceived riskiness of SME borrowers, weaknesses in the commercial law and security interests (especially prior to the introduction of OHADA), the absence of a credit reporting agency (see below), and a weak accounting and auditing framework (see previous section).

- **Savings are mostly kept outside the banking system due to lack of confidence and fears of a loss of access**. Under current regulation, when a third party debtor notification is issued the bank deposits of a counterpart with an outstanding tax liability are blocked.

- **Credit costs are very high due to high operating (e.g., network costs, cash management, and electricity) and liquidity costs, non-remunerated reserves, and lack of competition**.

50. A 2011 policy of paying all civil servants via bank accounts is aimed at fostering inclusion and enhancing public finance management (PFM). Fifteen banks participate in the (gradual) "bankarization" of 987,000 civil servants employees. Technical problems caused delays in its application, but the use of mobile payments has helped ease some of these. By August 2013,

[13] Article 74 of the banking law, allowing the central bank to set up one or more deposit guarantee systems, has been the basis for considering a deposit protection system under the 2010–13 government action plan.

[14] The DRC ranked 181 out of 185 countries in "Doing Business" 2013 and 160 out of 180 in "Transparency International's Corruption Perceptions Index". These indicators should be interpreted with caution due to a limited number of respondents, a limited geographical coverage, and standardized assumptions on business constraints and information availability.

60 percent of all civil servants were paid through banks (representing 64 percent of the wage bill). In rural areas, where bank penetration is limited, bankarization remains challenging with payments temporarily reverting to the former payment channels (the Caritas network, in particular) since August.

51. Work on payment systems is progressing but with severe delays. Instruments and the legal and regulatory environment needs to be modernized, as well as the capacity of the BCC's Payment Systems Directorate (DSP)

- **Payments are mainly done in U.S. dollars and in cash**. Weak payment systems, lack of confidence, and a fear of a repeat of the experience in the 1990s (i.e., hyperinflation and large depreciations of the CGF), the informal economy, and limited use of banking services explain the continued use of cash transactions. The gradual introduction of higher denomination notes (up to CGF 20,000 the equivalent of US$21), replacing small-denomination bills, is aimed at easing some constraints, but the exchange process is proceeding very slowly. Checks are rarely used, are costly, and weaknesses in the automated clearing system over constraint. E-payment solutions are also recent, costly and limited.[15] The regulatory environment governing the use of e-money should be reviewed to increase the competitiveness of the sector and to enhance consumer protection.

- **The 2004 National Payment System program is suffering from important delays**. In response, five private banks launched a switch, which is a duplication of the government's forthcoming National Interbank Electronic Payment System. An assessment of both systems' technical soundness, governance, access by the other institutions, implementation timeframes, and flexibility is to be completed soon and result in the selection of just one system. Also, the real-time gross settlement (RTGS) system for the payment of large amounts and the automated clearing house (ACH) for retail payment processing are unlikely to be operational before end-2015. One challenge will be to ensure that the payments systems will be compatible with the highly dollarized nature of the system of the Democratic Republic of the Congo.

- **Private individuals use domestic money transfer services mostly in U.S. dollars and provided by 61 BCC-licensed money transfer agents (only half are active).** There is little information about volumes of activity and there is weak supervision of the activities. A scaling up in the verification and supervision of activities is needed also for consumer protection purposes.

- **The legal framework for payment systems and instruments must be reviewed and updated to include a number of provisions to the operation of payment systems**. These include irrevocability and finality of payments (in particular a dispensation from the zero-hour rule that

[15] Debit cards are expensive, automatic teller machines (ATMs) are only available in a few cities, withdrawals are limited to within the issuing bank's network are of limited acceptance among merchants. Most transactions take place in U.S. dollars even if, recently, some limited services are being provided in CGF. The use of mobile payment services continue growing apace, but remain also limited, with only 10 percent of the close to one million customers, having signed up for mobile payment services actively use them.

retroactively renders ineffective all transactions carried out by a participating insolvent institution after midnight on the day on which bankruptcy has been declared), the financial guarantees system, multilateral clearing operations and the related e-proof, and the supervisory and regulatory powers conferred on the BCC. And, except for very limited cases, credit balances with mobile phone operators should remain available to creditors' attachments.

52. **The legal framework on credit information systems should clarify the BCC's supervision mandate and consumer protection—bank secrecy and sharing information.** The BCC's credit registry, established in 2001, compiles data only from banks and, while suffering from technical difficulties. Its modernization was due by end-2013. The process has suffered delays due to banks' concerns about the legal framework allowing them to share information about individuals. Also, the 2008 BCC project to establish a credit bureau that provides detailed and reliable information on individuals, ratings, portfolio monitoring, and others has made little headway. The credit bureau and the credit registry need to be connected.

53. **The unpredictability of the legal and judicial systems, the weak capacity in commercial tribunals, and unregulated critical professions to the application of law (e.g., notaries, clerks) are hindering effective financial intermediation**. Only few types of collateral are accepted (cash deposits, bank guarantees, and letters of comfort) and debt restructurings are preferred to commercial enforcement mechanisms. Joining OHADA in September 2012 has strengthened the most critical areas of business law, credit, and insolvency law but, while directly applicable, these need to be made compatible with the domestic law. Furthermore, the contract law, the banking and financial contracts law (including loan contracts), the law on negotiable instruments (bills of exchange, checks, commercial papers), and the property law (land activities falling under national jurisdiction, such as some mortgage-related aspects) need also to be modernized.

ANTI-MONEY LAUNDERING

54. **The risks of money laundering in the Democratic Republic of the Congo are considered high**. Generally, corruption and bribery, illicit arms trafficking, smuggling in precious stones and metals and other natural resources (oil, timber, wildlife, etc.), drug trafficking, and customs violations are considered to be the most important proceeds generating crimes. While a substantial amount of criminal proceeds are being laundered in cash, banks, money remitters, currency exchange bureaus, dealers in precious stones and metals, and professionals involved in the purchase and sale of real estate are deemed particularly vulnerable to money laundering. These risks are accentuated by the cash-based nature of the economy, its high rate of informality, the permeability of borders, as well as the weakness of government institutions.

55. **Ten years after the adoption of the AML/CFT Law (No 04/016 of July 19, 2004) it remains poorly implemented**. This law criminalizes money laundering, sets forth customer due

diligence (CDD) measures applicable to financial institutions[16], and imposes an obligation to report suspicious transactions to the domestic financial intelligence unit (*Cellule Nationale de Traitement des Renseignements Financiers–CENAREF*). First, the CDD requirements are generally ignored by the most vulnerable sectors; second, regulatory and supervisory bodies, including the BCC, have yet to develop and implement adequate AML/CFT control procedures; and third, aside from the CENAREF, law enforcement authorities lack the capacity to investigate and prosecute money laundering cases—out of the 5 files provided by the CENAREF to the Prosecutor's Office (Parquet General), only one case resulted in a conviction for money laundering.

Table 8. Democratic Republic of the Congo: Key Recommendations (Extended)

Recommendations	Priority 1/
Macrofinancial and Banking Sector Risks	
Complete the clean-up of the BCC and its recapitalization.	Short-term
Develop a liquidity forecasting framework at the BCC to help inform monetary policy decisions. To help achieve this, the MOF must agree to share information with the BCC on a regular basis on its cash flows.	Medium-term
Improve quality and frequency of availability of macroeconomic data and acquire specialized training in macroeconomic and regulatory issues.	Medium-term
Financial Stability	
Strengthen the legislative framework by adopting the banking law draft, and the draft law on the statutes of the central bank, granting the BCC autonomy and operational independence (including adequate capitalization), making it accountable and transparent, and mandating that it ensure the stability of the financial system.	Short-term
In the legislative framework, complete the range of sanctioning powers available to the BCC, so it has the means to ensure the stability of the financial system.	Medium-term
Introduce a process to improve and validate data quality to permit proper risk assessment.	Short-term
Improve the development and analysis of the FSIs.	Short-term
Create a unit to conduct vulnerability tests periodically and integrate the banks' individual stress tests in the analysis of financial stability.	Medium-term
Increase the required dollar reserves and liquidity requirements for dollar deposits.	Medium-term
Authorize the tax deductibility of provisions for bad debts and write-offs.	Medium-term

[16] The CDD measures of the AML/CFT law are not applicable to nonfinancial businesses and professions.

Banking Supervision and Bank Resolution	
Introduce in the legislative and regulatory framework a general framework for crisis prevention, preparation, and management.	Medium-term
Amend the legislative and regulatory framework for intervention in the banks and liquidation in order to eliminate the weaknesses of the current mechanism and improve its effectiveness. Introduce in the legislative and regulatory framework a general framework for crisis prevention, preparation, and management.	Medium-term
Build on the revision of the laws on credit institutions and on the central bank's statutes to harmonize the legislative framework for financial sector supervision.	Medium-term
Introduce in the legislative and regulatory framework a general framework for crisis prevention, preparation, and management.	
Introduce in the legislative framework a provision empowering the central bank to limit the activities of a credit institution that is in a degraded situation that is likely to continue.	Medium-term
In the legislative framework, complete the ranging of sanctioning powers available to the central bank so it has the means to ensure the stability of the financial system.	Medium-term
Revise the regulatory mechanism for supervision, completing it by taking into account standards and best practices for risk-based supervision.	Medium-term
Set up a truly preventive supervisory function by strengthening technical skills and changing working methods.	Short-/medium-term
Set up structured regulatory monitoring.	Medium-term
Set up preventive resolution plans.	Medium-term
Develop a body of procedures and methodological guides for supervision and develop risk assessment tools.	Medium-term
Adopt provisions on preventing conflicts of interest.	Medium-term
Introduce in the law on the central bank's statutes a provision providing legal protection for the central bank and its staff against potential law suits.	Medium-term
Develop regular cooperation with other supervisors.	Medium-term
Revise and strengthen current regulations on provisioning and the classification of NPLs.	Short-term
De-dollarization	
Adopt a road map for de-dollarization that includes milestones on fiscal consolidation, building of credibility by the central bank, endogenous creation and strengthen overtime of the transmission mechanism of monetary policy, reduction of financial vulnerabilities, accumulation of international reserves, among others actions.	Medium-term
Access to credit and SME financing	
Prepare a BCC directive setting forth the requirements with respect to transparency in pricing and the calculation method for the comprehensive effective rate.	Medium-term
Define the conditions under which financial institutions can use agents to provide financial services.	Medium-term
Revisit the draft leasing law in the context of the OHADA framework and get it passed.	Medium-term

Microfinance	
Conduct a review of all pieces of the legislation (laws and directives) on credit institutions, savings and loan cooperatives, and MFIs to ensure consistency.	Medium-term
Amend the law on savings and loan cooperatives in order to bring it in line with OHADA and establish a minimum capital requirement.	Medium-term
Prepare a directive on consumer protection.	Medium-term
Strengthen controls and the analysis of the reliability of financial data from savings and loan cooperatives and MFIs.	Short-term
Strengthen on-site audits of savings and loan cooperatives and MFIs in order to facilitate the inspection of the 36 main institutions during a cycle not exceeding two years.	Short-/medium- term
Study the possibility of phasing in a delegated supervision system for savings and loan cooperatives through their umbrella entities.	Medium-term
Continue the sanction process for all savings and loan cooperatives and MFIs that fail to comply with prudential requirements, and initiate the liquidation of all those that are unable to provide credible recovery plans.	Medium-term
Public interventions to expand access to financial services	
Ensure the verification by the BCC of the operational mechanisms put in place by the banks as part of efforts to promote use of banking services by civil servants employees (including effective opening-up of individual accounts).	Short-term
Allow civil servants to choose the bank at which they wish to be paid (as soon as the payment infrastructure permits).	Medium-term
Ensure regular payments of wages owed as part of efforts to promote use of banking services by civil servants.	Short-term
Identify the measures to be adopted to ensure the timely payment of civil servants in the event that a bank defaults or encounters operating difficulties.	Medium-term
Finalize negotiations between the state and the banks to ensure the wage payments of civil servants in rural areas (payment methods and terms and conditions governing remuneration).	Medium-term
Adopt a plan to restructure (or liquidate) CADECO based on fiscal costs and risks.	Short-term
Explore the possibility of having SOFIDE intervene indirectly through banks in order to promote SME financing.	Medium-term
Conduct an independent review of SOFIDE’s portfolio as of end-2013 (based on international standards).	Short-term
Payment methods and systems	
Pass the draft law on payment systems covering areas, such as the irrevocability and finality of payments, exemption of the accounts from seizure, e-proof, and the BCC’s supervisory and regulatory powers.	Short-term
Conduct a comparative review of the SMNI project and banks’ switch initiative in order to ensure that BCC and financial institutions identify the best option.	Medium-term
Effectively implement a system for supervising payment systems and methods at the BCC, including e-money.	Medium-term
Make preparations, in collaboration with the banks, for the introduction of an RTGS system capable of managing both CGF and U.S. dollar transactions (payment	Medium-term

agent and operating principles).	
Prepare the tax and pricing provisions applicable to the SNP.	Medium-term
Establish and convene the National Payments Council.	Medium-term
Strengthen supervision of money transfer services (licensing, solvency, consumer protection).	Medium-term
Modernize the legal framework applicable to mobile payments (exemption of funds from seizure, missions and powers of the BCC and the ARPTC).	Medium-term
Credit information	
Make the BCC's new credit registry operational, through greater involvement of financial institutions.	Short-term
Set up a modern legal framework for credit information systems.	Medium-term
Introduce a supervisory function for credit information systems at the BCC.	Medium-term
Identify, in collaboration with all stakeholders, the priorities for increasing the availability of credit information.	Medium-term
Insolvency and creditor rights	
Pass a law of introduction of OHADA, expressly abrogating domestic law provisions that are contrary to the Uniform Acts and ensuring compatibility of domestic law provisions with OHADA.	Medium-term
Make the report identifying all domestic law provisions that are contrary to the Uniform Acts readily available on the Internet.	Medium-term
Strengthen financial and human resources (especially officers of the court, research departments and the inspectorate general) for commercial tribunals.	Medium-term
Amend the law on commercial tribunals to bring it in line with the OHADA Uniform Acts, review applicable procedures, and make provisions for the payment of consular judges at commercial tribunals.	Medium-term
Begin the implementation of a program to establish commercial tribunals in the 11 provinces.	Medium-term
Modernize the system for notaries public, clerks of the court, process servers, valuation experts, and receivers, insolvency administrators (including conditions governing access and exercise of the professions, ethical standards, and disciplinary system, in particular).	Medium-term
Modernize the law of contract, the law on banking and financing contracts (including loan contracts), and the law on negotiable instruments (bills of exchange, checks, commercial papers).	Medium-term
Establish the RCCM (financial resources, internal organization and procedures, database, IT tools, staff, etc.).	Short-term
Strengthen the security of land titles and implement policies to formalize property ownership.	Medium-term
Inform financial institutions of the new options offered by OHADA law, in particular in the area of enforcement of collateral.	Short-term
Insurance	
Promulgate an amended insurance code to strengthen the governance and powers of the supervisor.	Medium-term
Revisit the minimum capital requirement level set at US$10 million.	Medium-term
Initiate operational preparations for the introduction of the supervisor once	Medium-term

the Insurance Code has been approved.	
Set up accounting principles specifically applicable to the insurance sector, which are consistent with international standards.	Medium-term
Put in place a restructuring/resolution plan for SONAS based on risks and fiscal costs.	Short-term
Pensions	
Initiate a reform process to ensure an actuarial balance and explore the possibility of extending the coverage of pension plans.	Medium-term
Ensure that institutions responsible for pension management (INSS or others) have an adequate organizational structure, IT tools, and resources in place	Medium-term
AML/CFT	
Develop a multi-sectoral AML/CFT national strategy that would prioritize the implementation of AML/CFT measures in the most vulnerable sectors.	Short-term
Reinforce the structure and the independence of the national financial intelligence unit.	Short-term
Review the domestic AML/CFT law to ensure that preventive measures to detect potential illicit financial flows are applicable to all reporting entities, in particular to dealers in precious stones and metals.	Medium-term
Include AML/CFT as part of criminal justice strategies to fight important crimes and build capacity within the law enforcement community on financial investigations.	Medium-term
1/ Short-term: < 12 months; medium-term: 12–36 months.	

Appendix I. Central Bank: Autonomy and Monetary Policy Tools

56. The new Central Bank of Congo (BCC) Law and the Banking Laws are pending approval. The new BCC Law will grant the BCC an explicit financial stability function with corresponding powers, enhance its personal, functional, and financial autonomy, and strengthen its governance, transparency, and accountability framework. Drafts of these laws have benefited from IMF Legal Department's technical assistance.

57. The new Banking Law would provide the BCC the toolkit to supervise and resolve banks. The draft Law provides the BCC with the powers needed to deal with the various stages of troubled banks: early intervention powers would enable the BCC ensure a restoration of a bank's solvency while leaving it under private control; or, if needed, full intervention and resolution with some bailing in features affecting shareholders and unsecured creditors but protecting small depositors.

58. The operation of the BCC is severely constrained by its weak capital position. Even after the recapitalization agreement with the ministry of finance (MOF), the BCC's financial position is weak, affecting its independence. Important structural reforms that would help alleviate this problem, such as the injection of fresh capital and the BCC's withdrawal from non-essential operations (the hospital and the mint), are still pending. And, the BCC is in the process of introducing the IFRS for its accounting to revalue its assets which will lead to further capital needs.

59. The recapitalization and rationalization of the BCC's balance sheet is needed to restore confidence on the CGF. In 2011 and 2012, the MOF issued recapitalization bonds amounting to CGF 1,249 billion to bring the BCCs net worth to zero. In a second phase, the BCC's capital was to be increased to a CGF 213 billion through additional recapitalization bonds amounting to CGF 104 billion and the revaluation of the BCC's fixed assets (equivalent to about CGF 109 billion). The current recapitalization bonds bear interest set annually by the MOF and independently of market conditions. In the absence of a sovereign debt market, an objective pre-defined mechanism for defining the interest rate on these instruments would be desirable. The cost of the recapitalization has been estimated in an initial draft amendment of the BCC law submitted to parliament at about CGF 1,353 billion (or 7 percent of GDP). In addition, the cost structure of the BCC needs to be rationalized to ensure BCC's operations are conducted efficiently and results are positive.

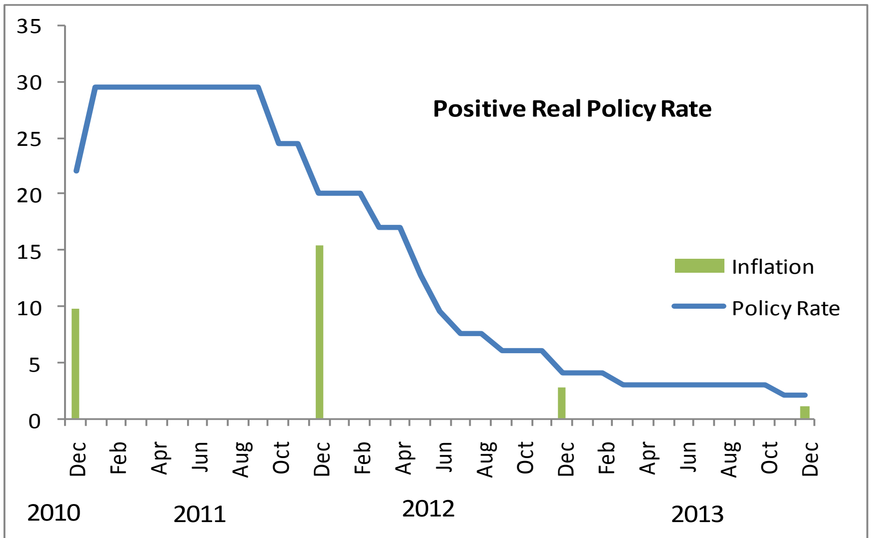
Table I.1 Democratic Republic of the Congo: Central Bank—Gross Operating Income

	2012	2011
Proceeds from monetary operations	42.9	42.2
Costs of monetary operations	39.1	75.9
Margin on monetary operations	**3.8**	**-33.7**
Margin on banking operations	**162.3**	**159**
Added value	**112.8**	**73.8**
Personnel costs	68.9	58.7
Write backs on provisions due	20.2	31.6
Allocations to provisions due	17.7	33.2
Gross Operating Income	**16.6**	**-16.3**
Allocation to amortization and provisions not due	17.1	53.1
Earnings from Period to be Allocated	**5.3**	**-59.8**

Source: BCC.

60. The BCC's monetary policy instrument, the interest policy rate, is defined by the inflation rate plus a premium of 2–10 percentage points. The real rate is always positive by construction. But, the monetary policy transmission is very weak due to the economy's high level of dollarization and limited access to financial services by the largest part of the population who primarily hold local currency. Furthermore, following the BCC's operational framework, the nature of monetary interventions is determined as a function of the source and duration of deviations from the monetary programming exercise, and the BCC's projected balance sheet. The system is currently experiencing excess liquidity in the system mainly due to large government deposits earmarking investments and weak credit supply that is parked at the Central Bank as remunerated reserves.

Figure I.1. Democratic Republic of the Congo: Policy Rate Evolution Over Time



Source: BCC

61. Monetary policy instruments available to the BCC are:

- **Treasury bill (BTR)[17] auction:** Weekly and monthly BTR auctions, currently with maturities of 7 and 28 days, are the principal market-based instrument to respond to temporary monetary shocks. By end-2012 the stock of BTRs was CGF 95 billion, and almost doubled in 2013 to reach CGF 182 billion in October.

- **Exchange market interventions:** Interventions are aimed at smoothing out exchange rate fluctuations and achieve the BCC's international reserves target. Monetary sterilization is used, when appropriate, to offset any effect on the money supply. The exchange rate has, in fact, remained remarkably stable around in recent years, prompting the IMF to reclassify the de facto exchange rate regime under "other management arrangements."

[17] Since March 14, 2014, these are now known as BCC bonds.

- **Changes in the required reserves conditions for commercial banks (currently 8 percent for sight deposits):** This instrument is rarely used. In October 2013, the rate was increased from 7 percent to 8 percent for sight deposits only in an effort to encourage longer-maturity deposits. Required reserves do not earn interest and are set in domestic currency.

62. There are important constraints on the effectiveness of monetary policy in the Democratic Republic of the Congo. These include the high level of dollarization, the lack of a well-functioning money market, institutional, and administrative weaknesses, fiscal dominance, and the lack of capacity and credibility of the monetary authorities. Given the highly dollarized economy, the BCC's role is mainly to provide U.S. dollar liquidity insurer and act as the government's fiscal agent.

63. The monetary transmission mechanism is weak. Monetary interventions to the interbank and credit markets are hindered by the lack of a well-functioning money market and by the financial exclusion of the bulk of the population. The limited depth and liquidity of the interbank money market prevents the banking system from effectively transmitting monetary impulses to the financial markets.[18]

64. The high level of dollarization is problematic because it limits the reach of the BCC policy. The dominant sectors of the economy (export industries, with extractive industries representing 98 percent of total exports) and financial services are largely immune to exchange rate fluctuations, and the BCC's policy interest rate has very little influence on borrowing decisions, which are mostly in U.S. dollars. And, monetary policy tools cannot be used as shock absorbers and to support growth and employment.

65. The formal local-currency economy is also relatively small and is dominated by the public sector. As a result, the fiscal policy stance has a vastly disproportionate influence on monetary developments.

66. Financial fragmentation impairs the ability to influence the money supply through market-based instruments—i.e., the banks' money creation through their lending activity. Three-fourths of the money supply (M1) is in the form of cash held by the population without access to the formal banking system (see also the section on access to the banking sector).

[18] There is currently no stock market in the Democratic Republic of the Congo.

Appendix II. De-dollarization: Preconditions, Operational Aspects, and Risks

67. International experience suggests that de-dollarization strategies are more likely to be successful if several conditions are in place. These include: (i) a track record of stable and low inflation; (ii) a well-developed financial and payment system; and (iii) a stable macroeconomic environment; and (iv) an effective financial regulatory framework. Success also is enhanced by a well-designed communication strategy aimed at building confidence in the domestic currency.

68. This experience also suggests that de-dollarization can be exceptionally challenging in highly dollarized economies. For example, there are no examples of countries with high levels of financial dollarization (higher than 80 percent) that have succeeded in reducing it to less than 20 percent. In highly dollarized economies, such as Bolivia, Peru, and Uruguay, financial dollarization has been reduced significantly, but the process has been very gradual and still remains above 40 percent. Countries, such as Poland, achieved faster progress, but had relatively low levels of dollarization and for a short period of time.

69. There are risks to de-dollarization, especially in the context of a vulnerable financial sector. A forced de-dollarization in the Democratic Republic of the Congo in the 1990s led to financial disintermediation (similar to the experience of Bolivia in the 1980s). To prevent the collapse of the economy, the authorities had to reverse some of their de-dollarization measures and allow for deposits in foreign currency. Ensuring a voluntary process that maintains the confidence levels in the economy and reduces risks of deposit runs would require a gradual process led by the central bank in collaboration with the MOF, entailing a range of steps including a reinforcement of the regulatory and legal frameworks.

70. Given that dollarization will likely take decades to be reversed, a financial system under a dual-monetary system, with proper regulation, is needed to provide necessary buffers for the transition to proceed smoothly. Today there is a local payment system in domestic currency but not in foreign currency. One of the consequences is that all major transactions in the country, which are conducted in U.S. dollars, have to be made through correspondent banks abroad and not through the local settlement system. The conditions for de-dollarization to occur in a gradual and successful manner should rest on the following pillars:

(a) Sound institutional frameworks, including those that would help assure fiscal consolidation, the de facto autonomy of the Central Bank, and strong monetary policy and banking supervision;

(b) Strengthening the domestic currency (i.e., achieving stable and low inflation, a stable financial and an efficient payment systems) through a sound macroeconomic framework and an appropriate market-oriented regulatory framework to deal with FD; and

(c) Undertaking coordinated actions to change people´s behavior (e.g., compulsory listing of prices in CGF). The response by people to the de-dollarization strategy is not immediate because changes in social habits take a long time. Therefore, some microeconomic actions could be implemented to facilitate a coordinated de-dollarization by economic agents.

(d) Penalizing the holdings of U.S. dollar deposits and loans relative to those in domestic currency, by requiring for instance higher required reserves and provisions in U.S. dollar operations.

Appendix III. The Resolution of the Banque Congolaise

71. The Banque Congolaise (BC) was one of the two largest banks in the Democratic Republic of the Congo back in 2008. It held 16 percent of the total deposits and issued 25 percent of the total credits**.** As part of a rapid growth strategy, in 2007, the BC acquired from the government the good part [« potentiel utile »] of Union de Banques Congolaises under liquidation. Its rapid growth was at the expense of the weakening of its financial structure; the bank's solvency ratio was 5.9 percent at end-2007 and 7.7 percent by end-2008, well below the 10 percent statutory minimum requirement. The BC was highly leveraged, heavily exposed to the sovereign, and inadequately provisioned. By January 2009, the BC's loan-to-deposit ratio was at 116 percent (and 166 percent if including the restructured claims on the government of the Democratic Republic of the Congo), well above the 74 percent sector average. In March 2009, the bank held about US$65 million (or 20 percent of its balance sheet) in government loans that were restructured in November 2008, and its NPL portfolio was provision at only 4 percent.

72. Poor management practices, weak corporate governance, and government interference with normal business activities seem to have compromised the bank's financial performance. Notably, strict enforcement of prudential norms and a collateral-based liquidity support by the BCC would have encouraged a timelier response to these problems and limited the costs to the state. The BC had been in violation of key banking sector prudential regulations since 2007. By the time of the central bank's intervention, 38 percent of loans were to connected obligors (mainly politically-connected individuals, bank shareholders, and board members) and were nonperforming. And, despite the several on-site inspections conducted by the BCC, weaknesses on connected lending persisted and no corrective action was taken.

73. Furthermore, supervision and auditing failed to uncover gaps in the accuracy of the BC's balance sheet position. Despite onsite inspections and close supervision, losses were hidden and the balance sheet of the bank was not reflecting the deteriorating quality of the portfolio due to misclassified loans, over estimation of the bank's net worth and of earnings, weak provisioning and accounting practices applied on some claims, including for a supposed profit on the value of the government's claim. At the time of liquidation, doubtful positions on the BC's balance sheet (item "Other creditors and regularization of liabilities" amounted to US$95.7 million and "other debtor and regularization of assets" to US$44.3 million) accounted for more than 50 percent of the total balance sheet. Identifying the true position of the bank at the time of resolution proved a very difficult task, with unreconciled assets in the balance sheet declining to 17 percent of total assets only after a year.

74. The BC was put into conservatorship in October 2010 and remains unresolved. When the liquidation of the BC was decided in October 2010, the BCC's exposure to the BC amounted to some US$120 million. Regulatory forbearance had lead to the accumulation of losses and the increase in capital needs, increasing the burden to the economy substantially over time. The BCC's guarantees of the BC's interbank liabilities limited contagion spreading through the system.

Appendix IV. Observance of the Basel Core Principles

Introduction

75. The financial sector assessment of compliance with the Basel Core Principles (BCP) for Effective Banking Supervision was undertaken in the context of the 2014 FSAP of the Democratic Republic of the Congo. The assessment was conducted by a team of experts from the IMF and the World Bank. The assessors met with the Governor and Vice Governor of the Central Bank of the Congo (BCC), with many representatives of the private financial and nonfinancial sector, and the auditors. The team worked in close collaboration with the BCC's Directorate for the Supervision of Financial Intermediaries (DSIF) and on the basis of information and documents provided by the DSIF before and during the assessment mission.

76. The assessment covered the framework and the practice of banking supervision at the BCC. The assessors analyzed the legislative and regulatory framework with respect to the financial sector and performed a detailed review of the policies and practices implemented by the central bank in the supervision of credit institutions. The assessment covered all credit institutions subject to the law on credit institutions and to the supervision of the BCC.

77. The BCC is the sole authority responsible for the supervision of the financial system in the Democratic Republic of the Congo. The central bank has the legal power to license banking institutions, to ensure their ongoing supervision, to verify their compliance with legislation, and to take timely corrective measures to remedy problems of safety and soundness. Under the current legislation, the BCC's mandate covers banks and all other nonbank credit institutions, such as savings and loan cooperatives, specialized financial institutions, finance companies, and MFIs. The BCC also exercises control over moneychangers and financial messaging services. In addition to its power to license these various institutions and to supervise them off-site and on-site, the central bank is responsible for establishing the regulatory and prudential rules governing their activities. Some nonbank institutions are also covered under other specific legislative frameworks.

78. The current legal, regulatory and prudential framework applied by the BCC does not explicitly give the BCC the function of exercising risk-based supervision (Table 4.1). In addition, while the independence of the central bank in the exercise of its banking supervision mission is not specifically mentioned in the laws, it is restricted due to its financial situation.

79. Important capacity constraints and insufficient expertise put important strains to the BCC's supervision capacity. For several years, the central bank has made significant efforts to improve the prudential framework and the conditions for performing its supervisory inspections to banks and intermediaries in the microfinance sector. However, the self-assessment produced by the central bank in preparation for the assessment often lacked depth and was sometimes approximate. Several years of armed conflict and macroeconomic imbalances have significantly hindered progress in the strengthening of the institutional framework and capacity building efforts.

Key Findings and Recommendations

80. Supervision seems to largely rely on a series of checks on compliance with laws and regulations rather than a risk assessment approach (Table 4.2). The regulatory framework currently in effect does not incorporate a number of Basel Committee standards and good practices that constitute the basis of risk-based supervision. These affect, for instance, the classification and provisioning of loans; monitoring loans to related parties; principles of management and supervision of various risks, such as interest rate, liquidity, or operational risks; business continuity plans; lack of powers to reject the transfer of banks' control without the endorsement of the central bank and others.

81. Credit institutions have not yet developed an internal risk management framework. The still embryonic credit institutions' risk management systems need to be further developed in line with the gradual shift of supervision practices towards risk-based supervision. In this vein, the prudential framework would need to be complemented with provisions promoting a risk management function within financial institutions covering all significant risks, crisis scenarios and granting the sufficient level of resources, autonomy, authority, and access to the board of directors to carry out the tasks effectively. On-site inspectors would also need to have a methodological framework for analyzing supervised institutions' risk management systems, evaluate performance, and verify exceptions. Furthermore, in order to better monitor and understand banks' risks, on-site inspections should be more systematic and regular and should cover all institutions, including MFIs.

82. The central bank's implementation of the existing regulatory framework is not sufficiently stringent. The legal framework is generally appropriate but the legislative and regulatory mechanism lacks clarity and the central bank does not seem able to enforce supervised institutions' strict compliance with the regulatory provisions applicable to them. Furthermore, implementation of the BCC's assigned powers is still inadequately supervised. The revision of the BCC law and of the law on credit institutions should help clarify mandates, functions and the prudential, resolution and backstopping toolkit at its disposal.

83. The mission found the need to strengthen the BCC's accountability framework on supervision activities. This would include the annual publication of a report on its supervisory activity with its publication in the Official Journal of the Democratic Republic of the Congo. Legislative and regulatory texts in effect relating to the supervision of credit institutions would also benefit from free on-line access.

84. The provisioning rules need to be revised. The current regulatory framework on loan classification and provisioning understate bank's risks. The ongoing IFRS-related work already provides some needed inputs as regards to rules for early detection of doubtful claims, a clearer notion of classified claims, differentiated rules for the treatment of rescheduled and restructured claims, and a strengthened provisioning of NPLs based on a revision, after in-depth analysis, of the weighting of eligible guarantees.

85. The central bank's powers in the area of corporate governance need to be strengthened in line with best international practices. The current regulatory framework has yet to be updated to cover the new best practice requirements on boards and board members regarding guiding strategy and supervising the establishment and on surveillance of the internal control environment and the management of all risks. Furthermore, there is no specific criterion or provision defining "good" corporate governance within the credit institutions and allowing for its operational monitoring and evaluation. The mission found the need for defining criteria for judging the competence and propriety of directors, appointing experienced independent directors, assessing the role of the board of directors in implementing the strategic guidelines of the bank, risk acceptance levels and the strategy followed, preventing and managing conflicts of interest, etc.

86. An effective monitoring of risks (e.g., risk concentration and liquidity risks) should cover the BCC and but also banks' internal practices. Credit institutions should be required to monitor a number of second order concentration risks, such as exposures to counterparties whose solvency often hinges on a single commodity' price fluctuations and liabilities and assets other than loans. Furthermore, credit institutions need to have an internal liquidity risk management framework and on-site supervision should also monitor this work, as well as the strengths and weaknesses of the banks' internal control systems.

Table IV.1. Democratic Republic of the Congo: Summary of Results from Detailed Assessment

Core Principle	Comments
1. Responsibilities, objectives, and powers	Responsibility for banking supervision is clearly assigned to the Central Bank. The mission assigned to it does not correspond to the definition of risk-based supervision and the objectives are not clearly defined. The Central Bank has the legal power to exercise the different functions of supervision but the implementation of this power is not asserted sufficiently. Finally, the regulatory framework is not regularly updated and implementation is not sufficiently stringent.
2. Independence, accountability, resourcing, and legal protection for supervisors	The Central Bank is not operationally independent from the Government which has severely influenced several bank cases. The Central Bank is given power to take prudential measures and decisions under its supervisory jurisdiction, but in several cases where the interests of the State and the responsibilities of the Central Bank in that capacity diverged, the latter did not take the actions that its mandate would have prescribed. No financial autonomy for the Central Bank, which is dependent on the Treasury. No provision on conflicts of interest and no provisions ensuring legal protection for Central Bank staff in their banking supervision functions.
3. Cooperation and collaboration	No provisions expressly authorizing sharing of confidential information.
4. Permissible activities	Banks are one of the credit institution categories engaged in banking operations along with savings and loan cooperatives, savings funds, specialized financial institutions, and finance companies.
5. Licensing criteria	Licensing criteria are limited and several cases raises question on the examination of licensing cases. Licensing is based more on a compliance approach than a risk-based assessment. No definition of criteria enabling the Central Bank to assess the competence and integrity of directors and members of general management proposed during the licensing process. Unsystematic evaluation of how much Board members know about each of the categories of activities contemplated by the bank and the associated risks. Need to improve knowledge of beneficial owners who

	ultimately control the institution and bank holding structures that could represent an obstacle to effective banking supervision.
6. Transfer of significant ownership	The Central Bank is authorized to examine and reject any proposal seeking to transfer to third parties significant direct or indirect investments or controlling interests in existing banks. Insufficient knowledge of beneficial owners with controlling interests. Limited powers to challenge an operation that would be in violation of legal and regulatory provisions.
7. Major acquisitions	Other than the prescribed thresholds, there are no explicit criteria for judging individual proposals on acquisitions. No prior authorization for an operation when it is within the authorized limits. No reporting of acquisition operations to ensure that banks do not take undue risks.
8. Supervisory approach	In the absence of a supervisory approach based on a risk analysis, both at the individual level and for the entire system, the Central Bank is not meeting the required conditions: a forward-looking assessment of risk profiles, a preventive detection process, an early intervention framework, and plans in place for orderly resolution.
9. Supervisory techniques and tools	In the absence, save for a few exceptions, of procedures and tools for the structured evaluation of the risk areas of each institution, and for analyses of the overall sector vulnerabilities, neither the methods nor the tools implemented fully comply with the recommendations issued by the Basel Committee for effective supervision.
10. Supervisory reporting	Absence of accounting reconstitution, preventing verification of the accuracy of the data submitted to the Central Bank. Need to supplement the Central Bank's knowledge of the risks posed by the credit institutions, in particular with regard to concentration or interest rate risk.
11. Corrective and sanctioning powers of supervisors	Although the Central Bank has a range of sanctioning powers, these powers must be strengthened with respect to essential criterion 4. In addition, its decisions should be more clearly explained.
12. Consolidated supervision	The Central Bank has particularly limited knowledge of the bank groups, especially those to which subsidiaries located in the DRC belong. Absence of regulations related to prudential supervision on a consolidated and cross-border basis, which could be

	conducted if required.
13. Home-host relationships	There is a need, as part of the upcoming discussions on the procedures for the introduction of Basel II, in particular Pillars 2 and 3, to develop cross-border relationships with a view to strengthening mutual understanding of the application of standards, in particular with respect to minimum capital and capital adequacy. The efficient and effective exchange of information and a mutual understanding of the activities and risks faced by institutions are likely to improve the prudential surveillance process and thus save resources.
14. Corporate governance	In the absence of legislative provisions on corporate governance, Central Bank Directive No. 21 establishes the corporate governance framework for credit institutions. This directive is quite general and does not consider the new requirements that international best practices impose on the boards of directors in the area of corporate governance. The Central Bank has not established any specific criterion or mechanism enabling it to ensure the establishment and implementation of good corporate governance in banks.
15. Risk management process	The Central Bank's supervision method still generally corresponds to checking compliance. In this context, the establishment of a framework specifying the risk management system for credit institutions is still embryonic and the Central Bank has not established a specific framework or reporting to ensure the implementation of its requirements in the area of risk management.
16. Capital adequacy	The Central Bank does not require lending institutions to set capital levels in anticipation of market events that could have an adverse effect, or to have in place contingency arrangements to be able to strengthen them in times of stress.
17. Credit risk	There is a need to strengthen the regulatory framework on monitoring of the total indebtedness of entities to which credit has been extended. Following the 2009–2009 crisis, the DSIF promptly conducted several on-site supervision missions to assess the quality of the credit portfolios of the major banks and the level of support from their shareholders. Supervision missions were carried out in 2010 and 2011; however, since that time, these missions have been conducted far less frequently, in anticipation of technical assistance.

18. Problem assets, provisions, and reserves	The laws and regulations on the classification and provisioning of credit risks are largely inadequate and obsolete.
19. Concentration risk and large exposure limits	The Central Bank does not conduct sufficiently regular supervision of concentration risks in the financial system, which is particularly regrettable as information from the credit reporting agency is not reliable.
20. Transactions with related parties	Related parties in the law on credit institutions are too narrowly defined. The regulations do not specify that the loans or guarantees granted to related parties can be granted only under the same conditions, for the same amounts, and for the same collateral and guarantees as those applicable to the other clients of the lending institution. Poor reporting on loans granted to shareholders, Board members, directors etc., in the absence of routine processing of BSA reporting statements (DEC 1411), for all institutions subject to supervision.
21. Country and transfer risks	While banks operating in the DRC are exposed due to assets held with foreign correspondents and syndication within some groups, there is no legislative or regulatory provision on monitoring country or transfer risk.
22. Market risks	A market risks monitoring framework was established but the Central Bank has not established a specific mechanism or reporting system enabling it to ensure the implementation of its requirements in the area of market risk management systems.
23. Interest rate risk in the banking book	A framework specifying the system for managing banks' interest rate risk has been defined by the Central Bank. The Central Bank has not established a specific mechanism or reporting system enabling it to ensure the implementation of its requirements in the area of market risk management systems.
24. Liquidity risk	Liquidity risk is one of the principal risks facing the banking system in the DRC. The established regulatory framework seems sufficient but the Central Bank has not established a specific mechanism or reporting system enabling it to ensure the establishment of an adequate liquidity risk management system in each credit institution based on its risk profile. In addition, the Central Bank should be sure to understand banks' liquidity risks on a forward-looking basis.
25. Operational risk	A framework specifying the system for managing banks'

	operational risk has been defined by the Central Bank, which has not established a specific mechanism or reporting system enabling it to ensure the implementation of its requirements in the area of operational risk management systems.
26. Internal control and audit	The Central Bank, through regulations implemented and the on-site reviews it conducts, has an appropriate framework in place, although harmonization of the legislation (internal control, governance, risk management) is essential. However, the plethora of letters addressed to the banks does not reflect a routine and in-depth analysis of the strengths and weaknesses of the supervision systems put in place in the banks. Furthermore, it appears that there was no critical analysis of certain governance memoranda.
27. Financial reporting and external audit	Regular meetings with the auditors should be organized. In addition, the expected content of the detailed report that the Central Bank requires from external auditors, pursuant to Article 12 of Instruction No. 19, should be defined.
28. Disclosure and transparency	Rules governing disclosure and transparency, apart from the publication of annual accounts, are not included in the regulations.
29. Abuse of financial services	A regulatory framework specifying banks' anti-money laundering system is in place. However it is flawed, since, inter alia, the Central Bank has not established a specific mechanism or reporting system enabling it to ensure the implementation of its requirements in the area of combating money laundering and has not conducted any on-site supervisory mission on this subject.

Table IV.2. Democratic Republic of the Congo: Summary of Recommendations from Detailed Assessment

Program of recommended actions for improving compliance with the Basel core principles and the effectiveness of the regulatory and prudential framework

Principle	Recommended action
1. Responsibilities, objectives, and powers	- Take advantage of draft revisions of the Banking law and the law establishing the Central Bank statutes to harmonize the entire current legal framework, which is the result of the accumulation of successive texts. This is all the more necessary since, in the OHADA context, certain legislative and regulatory provisions will have to be adapted. - When granting additional powers to the Central Bank, also include measures that strengthen the reporting requirements regarding its supervision activities. - Supplementing their publication in the Official Journal, guarantee free on-line access to legislative and regulatory texts in effect in the area of the activities of credit institutions and their supervision.
2. Independence, accountability, resourcing, and legal protection for supervisors	- Strive to preserve the independence of the Central Bank in its capacity as banking supervisor. - Set up a genuine training plan for all staff assigned to supervision and break it down into individualized itineraries, which will allow the DSIF to better express its needs to Central Bank authorities. - Give the DSIF adequate IT resources to make its work more effective. - Considering the time needed to train supervisors, set up career plans.
3. Cooperation and collaboration	- Formally organize cooperation with the Ministry of Finance (also ultimately responsible for financial stability), which could facilitate joint work and prevent conflicts of interest. - Introduce in the law on the organization and operations of Central Bank provisions allowing it to lift professional secrecy and authorizing the sharing of confidential information.
5. Licensing criteria	- Adopt a risk-based analysis approach when examining licensing applications. - Define criteria allowing the Central Bank to assess during the licensing process the competence and integrity of directors and members of senior

	management suggested by the institution. - Establish criteria for evaluating how much Board members know about each of the activity categories contemplated by the bank and understand about the associated risks. - Strengthen the Central Bank's powers and capacities in terms of knowledge of controlling beneficial owners and voting rights in credit institutions.
6. Transfer of significant ownership	- Supplement the legislative framework to give the Central Bank the ability to invalidate an operation that would be a violation of legal and regulatory provisions. - Set up a mechanism allowing the Central Bank to ensure that it always has full knowledge of beneficial owners with controlling interests. - Introduce a requirement that banks must inform the Central Bank, as soon as they become aware of it, of any significant information that could have a negative impact on the acceptability of a major shareholder or someone with controlling interests.
7. Major acquisitions	- Define explicit criteria for judging individual proposals on acquisitions. - Establish reporting of acquisition operations in order to ensure that banks do not take undue risks.
8. Supervisory approach	- Develop a framework for placing troubled credit institutions under special surveillance. - Promote forward-looking analyses, using, in particular, performance charts being implemented. - Continue to prepare a set of methodologies and instruments to detect financial developments that are likely to undermine the stability of the banking system. - Resume the project to rank credit institutions and to develop a system for banks evaluation based on a risk approach. - Fine-tune the definition of peer groups and link individual analyses to the situation prevailing in the system.
9. Supervisory techniques and tools	- Establish a structured set of methodological procedures and guides covering all supervision activities, with emphasis being placed on risk monitoring and assessment of the soundness of the institutions supervised and the financial sector as a whole.

	- Step up the pace and expand the scope of on-site supervision. - Conduct regular stress tests. - Ensure the effective supervision (reporting, on-site supervision) of specialized financial institutions.
10. Supervisory reporting	- Define and identify the checks to be carried out before the dispatch of regulatory returns by the credit institutions, in order to enhance their quality. - Verify, during on-site supervision, the accuracy of the data submitted to the Central Bank, in particular with respect to accounting or statements provided to the credit reporting agency. - Conduct a general review of the prudential information received by the Central Bank in order to harmonize it and strengthen the supervisors' knowledge of risk concentrations.
11. Corrective and sanctioning powers of supervisors	- Make provisions in the legal framework, as a preventive measure, for the Central Bank to intervene prior to regulatory violations. - Give consideration to adopting a more stringent procedure for revoking the license of a lending institution, when, over a prolonged period, the situation of a lending institution is extremely degraded (e.g., negative capital levels). - Strengthen, by law, the corrective and sanctioning powers of the Central Bank to correct practices or activities that could create risks for the institution or the entire sector. - Provide a detailed account in the Central Bank annual report of the sanctions imposed and violations identified. - Initiate discussions at the Central Bank in order to clarify in what situation, when, and how its various powers can be used and formalize the results in a procedure.
12. Consolidated supervision	- Establish a database on the structure of the banking groups headquartered in the DRC and outside of the DRC. - Strengthen the authority of the Central Bank to limit the types of activities conducted by banking groups as well as the places in which such activities may be conducted, in the absence of a competent authority to supervise parent companies and/or if the security of the institutions so warrants.

	- Direct institutions to establish a pilot program on the risk profile of activities conducted abroad and assess compliance with the internal controls related the local supervision of operations. - Draft regulations related to prudential supervision on a consolidated and cross-border basis, as well as the accounting regulations and schematic representations necessary for the establishment of consolidated accounts.
13. Home-host relationships	- Solve the issue of confidentiality before developing home/host cooperation. - Ensure that the home supervisors provide the Central Bank with the necessary information, in particular on: • The general prudential framework applicable to the banking group; • The bank or banking group, so as to allow the BCC to properly understand the activities conducted in the DRC; • The different activities carried out in the DRC; • The major problems encountered at the headquarters or at other offices of the group (where possible and appropriate), if these problems are likely to have a significant impact on the security and soundness of the subsidiaries operating in the DRC.
14. Corporate governance	- Establish specific criteria or a mechanism allowing the BCC to ensure effective implementation of good corporate governance in banks. - Revise Directive No. 21 on the corporate governance of credit institutions to incorporate the new international best practices requirements.
15. Risk management process	- Provide on-site supervision with a methodological framework for analyzing supervised institutions' risk management systems. - Establish specific criteria or a mechanism allowing the Central Bank to ensure the effective implementation of risk management frameworks. - Revise Directive No. 22 on the risk management process in order to incorporate the new international best practices requirements, particularly a risks management function and the establishment of stress

	scenarios.
16. Capital adequacy	- Revisit the issue of whether a bank's capital must be held in local currency while the bulk of the exposures are in foreign currency. - Make risk weighting of assets held with foreign correspondents more restrictive. - Conduct an impact assessment with a view to assessing the possibility of requiring higher risk weighting rates for counterparties that have not received an AAA, AA, or an equivalent rating. - For claims on the Government and central administrations give consideration to a weighting of at least 75 percent, or even 100 percent, for claims on all territorial administrations. - Use a weighting of 100 percent for accrual accounts, including all pending accounts. - Based on the results of on-site supervision, it appears that mortgages only marginally reduce the risks posed: the level of weighting for debt that includes mortgages should be reviewed. - Make provisions in the regulatory framework for the possibility of the BCC to require a weighting of 100 percent for risks for which no prudential regulations have been defined, instead of giving credit institutions a margin to maneuver. - Make provisions as well to strengthen current regulations by including a capital charge for market operations.
17. Credit risk	- Base the procedures implemented to supervise credit risk developments in the financial sector on a structured analysis of risk profiles. - Strengthen the prudential mechanisms with regulations on monitoring of the total indebtedness of parties to which credit has been extended. - Strengthen the prudential mechanisms on the intervention of the Board or management in the process of granting loans where there is a risk of conflict of interest.
18. Problem assets, provisions, and reserves	- Review the loan classification and provisioning rules, emphasizing early detection of doubtful claims, granularity of questionable overdrafts, provisioning of nonperforming loans, and weighting of guarantees. - Ensure banks' effective implementation of ongoing monitoring of loan portfolios.

	- Raise their awareness of the need to set up rigorous and diligent collection procedures.
19. Concentration risk and large exposure limits	- Implement, while awaiting enhancement of the credit reporting agency's reliability, an internal unit to handle large exposures. - Adjust the common weightings with the risk coverage mechanism, as stipulated in the recommendations set forth in CP 16 (e.g., weighting at 100 percent of exposures for which no prudential regulations have been established). - Implement, when appropriate, requirements for large exposures on a consolidated basis. - Require credit institutions to monitor certain less significant concentrations of risk (e.g., in the DRC, exposures to counterparties whose solvency is contingent upon price trends for a particular commodity).
20. Transactions with related parties	- Broaden the definition of related parties in the law on credit institutions and grant power to the Central Bank to further broaden the list in specific cases. - Stipulate in the regulations that loans or guarantees granted to associated parties can only be granted under the same terms, for the same amounts and using the same collateral and guarantees as those applicable to the other clients. - Specify that these transactions must be approved by the Board, and that Board members with a direct or indirect interest be excluded from the approval process. - Implement a system that allows the Central Bank to provide a realistic assessment of the procedures of the credit institutions in order to identify associated party risk. - Ensure the routine treatment of reporting statements on loans granted to shareholders, Board members, managers, etc. (DEC 1411), for all entities subject to supervision, and routinely submit the results of the analyses to management and the Governor.
21. Country and transfer risks	Incorporate into the prudential regulations provisions on monitoring country and transfer risks.
22. Market risks	Establish a framework or reporting on market risks monitoring implemented by credit institutions.

23. Interest rate risk in the banking book	Establish a framework or reporting on interest rate risk monitoring implemented by credit institutions.
24. Liquidity risk	- Verify that each institution has established a liquidity risk management framework suited to its risk profile. - Pay greater attention to the monitoring of this risk during on-site supervision. - Consider the possibility of the Central Bank's conducting stress tests in this area.
25. Operational risk	Verify that each institution has established an appropriate operational risk management framework based on its risk profile.
26. Internal control and audit	- Harmonize regulatory provisions on internal control, internal audit, governance, and risk management. - Initiate routine and in-depth analyses of the strengths and weaknesses of the internal control systems put in place by each lending institution, including analyses of governance memoranda received by the Central Bank.
27. Financial reporting and external audit	- Provide the credit institutions with the content of the detailed report that the Central Bank requires of auditors, in accordance with Article 12 of Instruction No. 19. - Organize regular meetings between the Central Bank and external auditors of credit institutions. - Incorporate into the legislative framework provisions protecting external auditors against a liability action whenever they make reports to the Central Bank on matters of material significance relating to the failure to comply with regulations.
28. Disclosure and transparency	Incorporate into the law provisions that strengthen requirements relating to disclosure of financial information and transparency, including risk exposures, risk management strategies, and the governance policies of credit institutions.
29. Abuse of financial services	- Undertake on-site inspections of credit institutions to check compliance with AML/CFT requirements. - Implement frameworks for monitoring the implementation of anti-money laundering systems and conduct on-site supervisory missions on this subject.

Authorities' Response

87. The Central Bank of the Congo (BCC) welcomes the detailed review of the regulatory and supervisory framework of the Congolese banking system carried out by the joint evaluation team of the IMF and the World Bank as part of the first Financial Sector Assessment Program (FSAP). This evaluation was used to measure the compliance of the supervision system in the Democratic Republic of the Congo under the Basel Core Principles for effective supervision, with the objective of assessing the risks to which the Congolese financial system is exposed.

88. Although there are some differences of opinion, the assessments have been a guiding tool for the Central Bank in the design of our action plan and its implementation timetable.

89. Accordingly, to implement the recommendations, the Central Bank will require of IMF and WB technical assistance. The program should make provision for this TA between the central bank and its partners.

90. In addition, although our comments were incorporated into the FSAP evaluation report, the Central Bank proposes—in those areas where differences of opinion remain—that the following BCC comments be incorporated in this report.

Core Principle	BCC Comments
15. Risk management process	The existence of a regulatory framework for risk management should justify a rating of grade of "materially non-compliant", even if the logic used in Instruction No. 22 is mostly relying on compliance and if there is no specific reporting for ensuring the implementation of the require risk management framework.
24. Liquidity risk	The existence of a regulatory framework (Instruction No. 22) giving some indication on the management of liquidity risk justifies a rating of "materially non-compliant," despite the lack of implementation of a process to ensure the BCC that an appropriate liquidity risk management framework is in place in each institution according to its risk profile and of a process to appreciate the liquidity risk with an anticipatory approach.
29. Abuse of financial services	The existence of a regulatory framework (Instruction No. 15) and the requirement of an annual reporting for banks justify a rating of "materially non-compliant," despite the lack of on-site supervision missions to check their reality.

Appendix V. Stress Test Matrix

Table V.1. Democratic Republic of the Congo: Solvency Stress Tests	
Scope	**Bottom-up by banks**
Institutions included	18 commercial banks
Market share	100 percent
Data and baseline date	Supervisory, December 2012
Methodology	Balance sheet sensitivity analysis and reverse stress tests
Stress test horizon	Static (point in time)
Shocks	***Sensitivity Analysis. Credit Risk***
	• Deterioration of asset quality/ NPL increase (25/50/100 percent) • Deterioration of asset quality in mining sector due to commodity price changes (50 percent) • Concentration risk (default of largest borrowers and of second largest borrowers) • Exposure to public sector finance/Role of state (50 percent increase in NPLs) • Reverse stress: loss to breach 10 percent CAR
	Market Risk • Exchange rate risk—shock to net open position • Interest rate risk: shift to local currency yield curve
	Multi-factor Assessment • Simultaneous multiple credit risk shocks.
Risks/factors assessed	• Higher provisioning expense as a result of credit losses • Earning losses from cost of funding increase • Solvency of banks, system
Calibration of risk parameters	• Based on actual point in time (historical highs) and proxies in the region (commodity price shock). • Expert judgment due to data limitation for a macro modeling.
Regulatory standards	• Basel II (accompanied by local regulatory standards)
Results	• Capital deterioration is observed

Table V.2. Democratic Republic of the Congo: Interest and Exchange Rate Risk Stress Tests	
Scope	**Bottom-up by banks**
Institutions included	All 18 commercial banks
Market share	100 percent
Data and baseline date	Supervisory, December 2012
Stress Test horizon	
Methodology	Sensitivity analysis and reverse stress tests
Risks/factors assessed	• Increase in interest rate; shifts in yield curve (500 basis points) • Depreciation of local currency (55 percent)
Calibration of risk parameters	Change in interest rate; Exchange rate depreciation
Regulatory standards	• Basel II and local regulatory standards
Results	Decline in profitability and capital position

Table V.3. Democratic Republic of the Congo: Network Analysis and Contagion Risk	
Scope	**Bottom-Up by Banks**
Institutions included	All 18 commercial banks
Market share	100 percent
Data and baseline date	Supervisory, December 2012
Methodology	Internal IMF models (Espinoza and Sole, 2010)/Credit and funding channel analysis
Risks/factors assessed	• Domino effects along the credit chain in case of a bank's default (systemic failure); • Short-term funding risk
Calibration of risk parameters	2008/2009 experience/current exposure to other banks/ad hoc shocks
Regulatory standards	• Basel II and local regulatory standards
Results	Found small fraction of interbank loans is domestically held. 98 percent of interbank loans are held abroad and data is limited for holdings of banks abroad.

Table V.4. Democratic Republic of the Congo: Liquidity Risk Stress Tests

Scope	**Bottom-Up by Banks**
Institutions included	All 18 commercial banks
Market share	100 percent
Data and baseline date	Supervisory, December 2012
Stress Test horizon	5-day horizon
Methodology	Bank-run test and funding risks
Risks/factors assessed	• Deposit run; (6/10 percent daily withdrawal for 5 days) • Capital flight regarding anxiety over de-dollarization efforts • Short term funding risk • Funding liquidity and market liquidity • Maturity mismatch/rollover risk • Concentration of funding (mining sector/commodity price shock)
Calibration of risk parameters	• Historical experience/ad hoc shocks
Regulatory standards	• Basel II and local regulatory standards
Results	Deterioration of liquidity condition