International Journal of Economics, Commerce and Management
United Kingdom Vol. III, Issue 5, May 2015
http://ijecm.co.uk/ ISSN 2348 0386

FINANCIAL SECTOR REGULATORY AND SUPERVISORY FRAMEWORK IN GHANA

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Abstract

The development and expansion of the financial sector of every nation largely depends on the regulatory and supervisory framework underlying the sector. After the 2007-2009 financial crisis, several forms of regulation have been instituted in many countries including Ghana to protect the financial environment from illegal dealings and transactions. This study examines the regulatory and supervisory framework of the financial sector in Ghana highlighting the strengths, weaknesses, opportunities and threats. In Ghana, sustained financial sector restructuring and transformation has succeeded in creating a vibrant financial system in the sub region. Ghana's financial system has undergone rapid growth and major structural transformation over decades, which has brought new opportunities and risks. Banks in Ghana are now in a position to effectively play active role as financial intermediaries. The authorities have been implementing reforms to strengthen the regulatory and supervisory framework and financial infrastructures. However, there remain cross-cutting challenges that need to be addressed. It is recommended that the Bank of Ghana, as the central bank with an overall supervisory and regulatory authority in all matters relating to banking business in Ghana, continues to ensure a sound, competitive and efficient financial system.

Keywords: Financial sector, Regulation, Financial system, Restructuring, Bank of Ghana

INTRODUCTION

Financial development requires an enabling environment for it to thrive. The probability that a country will suffer a banking crisis depends on global factors, contagion factors, and domestic factors (Forbes and Warnock, 2012 and IMF, 2013). The recent global financial crisis has prompted a renewed interest in banking regulation and supervision to safeguard global financial systems. As a result, a number of reforms of the financial regulatory framework have been agreed internationally, most notably the Basel accords developed by the Basel Committee on banking supervision's reform (Basel Committee, 2010a; 2010b). In Ghana, there is growing pressure to further strengthen regulation and supervision of financial institutions to protect the financial environment, especially the consumer.

An efficient financial sector provided the rudiments for income-growth and job creation, and therefore plays a significant role in economic development. Any financial system that is not effectively regulated runs the risk of creating weak financial institutions. The supervisory framework should include well capitalized institutions, reliable and adequate information, and a good legal framework with adequate enforcement provisions, transparency and disclosure requirements. Other issues include effective risk management systems in banks, adoption of a risk based approach to supervision, good corporate governance practices, strict anti-money laundering/CFT regulations, and the adherence to sound ethical principles (Addison, Asiamah and Abdulai, 2008).

The Bank of Ghana, over the years, has been making efforts to align its regulatory and supervisory framework with international standards, but important gaps remain. Several legislative improvements have been introduced; efforts have also been made to improve risk-based supervision as a precursor to implementing Basel Accord. However, despite major accomplishments on the legislative front and the efforts to strengthen supervision, most studies conducted have concentrated on banking regulation as referring to only banks neglecting the non-bank financial institutions. Amediku (2011), Obiri (2012), Salami and Larmie (2013), Mawutor (2014) have all, in one way or the other, concentrated on the assessment of the effectiveness of regulation of banks by Bank of Ghana.

This study reviews the regulatory and supervisory framework existing in Ghana to protect the financial environment. The study examines the mechanisms put in place to regulate banks and other non-bank financial institutions. The outcome of the study will help bridge the existing gap since many studies have covered banks and left other financial institutions unattended to despite the enormous significant contributions such institutions make in the development of Ghana's economy. The study will draw the attention of regulators and researchers to such key sector.

HISTORICAL OVERVIEW OF BANKING IN GHANA

According to Antwi-Asare and Addison (2000), the beginnings of the modern banking system in Ghana were in the late nineteenth century. The Post Office Savings Bank (POSB) began operations in 1888, using the facilities of post offices in the country. The British Bank of West Africa, now the Standard Chartered Bank (SCB), was established in the then Gold Coast in

1896, followed by Barclays Bank DCO, now Barclays Bank Ghana Ltd (BBG) in 1917. These banks were overseas subsidiaries of banks incorporated in the United Kingdom. Their operations were dominated by financing trade between the Gold Coast and the UK.

A Co-operative Bank was also established in 1935 by farmers' cooperatives and the colonial government. Apart from the POSB, the banks maintained branch offices in major mining towns, commercial centres and major cocoa-buying centres. Meanwhile, the British government established the West African Currency Board (WACB) in 1912 to issue currency of various denominations in the British colonies in West Africa (Gold Coast, Nigeria, Gambia and Sierra Leone) and redeem British currency. The colonial government was under considerable pressure from the locals because the two major existing banks (BBG and the British Bank of West Africa) favoured the European, Levantine and Asian communities in their operations. They advanced credit to indigenous entrepreneurs on only rare occasions (Antwi-Asare and Addison, 2000).

Sir Cecil Trevor was contracted in 1951 by the government to examine the whole field of banking in the Gold Coast, in particular, the question of setting up a National Bank on commercial lines. He recommended the formation of a bank partly owned by the government to be managed and staffed by locals. He emphasised that its aim should be to operate for the benefit of the indigenous private sector, while maintaining government accounts and acting as agent in the flotation of government bonds. Upon these recommendations the Bank of the Gold Coast was established and began operations in 1953 (Antwi-Asare and Addison, 2000).

After independence, Ghana left the WACB and split the Bank of Gold Coast into two banks. Central banking activities were hived off to a newly created Bank of Ghana, while the Ghana Commercial Bank took on the commercial banking activities. In the period immediately after independence the socialist policy-bias of the government, together with the associated lack of a critical volume of private sector capital, led to a government-driven development of the banking sector. Making use of the Bank of Ghana (BOG), the State Insurance Corporation (SIC), the Social Security and National Insurance Trust (SSNIT) and in one case a foreign investor many state-owned banks were established (as shown in .

In July, 1957, Alfred Engleston was appointed as the first Governor of the Bank of Ghana. As expected, the Bank of Ghana took over the management of the currency and in July, 1958 it issued its first National Currency - the Cedi - to replace the old West African currency notes. The Ghana Commercial Bank assumed the role and functions of Government bankers and began to take over the finances of most Government departments and public corporations. The Bank of Ghana quickly developed into a strong competitor of the expatriate banks by opening branches in most of the towns and centres in which they had been operating as well as moving into new areas such as the Ashanti and the Northern Regions. The advent of the new Government, elected by popular vote in 1957, brought the establishment of more banks.

Banks incorporated by legislation between the periods 1957 to 1965 include: the Ghana Investment Bank as an Investment Banking Institution; the Agricultural Development Bank for the development of Agriculture; the Merchant Bank for merchant banking; and the Social Security Bank to encourage savings. In conformity with the economic policy of the time all these institutions were incorporated as state-owned banks. 1983 saw an attempt to reverse the situation, the Government, with the assistance and guidance of the International Monetary Fund (IMF), introduced the Economic Recovery Programme (ERP). According to Antwi-Asare and Addison (2000), this signalled the end of Socialism in Ghana and provided a useful tool for economic development by embracing the market economy; privatisation; the liberalisation of trade and financial restrictions; and the divestiture of Government interests in public corporations. Import licensing was quickly abandoned and exemptions were granted in relation to many of the restrictive clauses of the Exchange Control Act.

Furthermore, an Investment Code was enacted to make provision for the relaxation of many of the earlier restrictions in trade and finance and to encourage private investments. These newly adopted concepts were incorporated into legislation, particularly in regards to banking, non-banking financial institutions and securities. Thus, the Banking Law was enacted in 1989, enabling suitable locally incorporated bodies to file applications for licences to operate as banking institutions. Subsequently, a number of corporate entities were licensed to operate as banks, including Meridien (BIAO) Trust Bank, CAL Merchant Bank, Allied and Metropolitan and ECOBANK.

By the end of 1990, banks were able to meet the new capital adequacy requirements. In addition, the government announced the establishment of the First Finance Company in 1991 to help distressed but potentially viable companies to recapitalize. The company was established as part of the financial sector adjustment program in response to requests for easier access to credit for companies hit by ERP policies. The company was a joint venture between the Bank of Ghana and the Social Security and National Insurance Trust.

The Ghana Stock Exchange began operations in November 1990, with twelve companies considered to be the best performers in the country. Although there were stringent minimum investment criteria for registration on the exchange, the government hoped that share ownership would encourage the formation of new companies and would increase savings and investment. After only one month in operation, however, the exchange lost a major French affiliate, which reduced the starting market capitalization to about US$92.5 million. In June 1993, Accra removed exchange control restrictions and gave permission to non-resident

Ghanaians and foreigners to invest on the exchange without prior approval from the Bank of Ghana. In April 1994, the exchange received a considerable boost after the government sold part of its holdings in Ashanti Goldfields Corporation.

AN OVERVIEW OF REGULATION AND SUPERVISION

The financial sector is one of the most heavily regulated sectors in the economy and banking is by far the most heavily regulated industry (Chortareas, Girardone and Ventouri, 2010). They submit that bank regulation typically refers to the rules that govern the behaviour of banks, whereas supervision is the oversight that takes place to ensure that banks comply with those rules. The issue of financial regulation – particularly in relation to the banking sector – is often considered a controversial issue. Different writers have put forward various arguments for and against regulation and supervision.

Writers such as Fischer and Reisen (1992); Noy (2004); and Mishkin (2001) contend that weakness of the regulation and supervision of the financial system is viewed as a major factor, contributing to the emergence of bank failures and, for that matter, financial crisis. It is argued that if financial liberalization is accompanied with weak prudential supervision of the banking sector, then it will result in excessive risk taking by financial intermediaries and a subsequent crisis (Demirgüç-Kunt and Detradiache, 1998; Edwards, 2000; Rossi, 1999; Mehrez and Kaufmann, 2000). According to (Gallardo, 2001), a primary reason for regulating and supervising traditional financial institutions is consumer protection for public depositors in financial institutions. Moral hazard issues arise because the interests of financial institutions vis-à-vis the interests of consumers per se are not necessarily compatible. Individual depositors and investors may not be in a position to judge the soundness of a financial institution (the issue of asymmetric information), much less to influence that institution's management. Thus, an impartial third party, such as the state or its agency, is required to regulate and control the soundness of a country's financial institutions. Since bank failures and problems tend to be contagious and affect other banks regardless of their soundness, the protection of the whole banking and payment system becomes an additional objective of regulation and supervision (Gallardo, 2001; Salami and Larmie, 2013).

On arguments against regulation, Barth, Caprio and Levine (2006) submit that regulation is costly and can give rise to moral hazard problems; in addition distortions between regulated and unregulated institutions can occur. Howell and Bain (2007) also note issues of moral hazard, agency capture, creation of compliance costs, and tendency to preserve monopoly resulting from the need to comply with regulations and related cost increases of entry into and exit from markets.

Ultimate objective of prudential regulation and supervision of the banking sector is, therefore, stabilizing the financial system and obtaining public confidence in its stability, as well as being able to manage systemic risk and protect clients. Hence, supervision and prudential standards should be improved so as to ensure that banks meet capital requirements, make adequate provision for bad loans, limit connected lending, and publish informative financial information, and that insolvent institutions are dealt with rapidly (Fischer, 1998; Mathieson and Rojas-Suarez, 1994).

There are theoretical models that stress the advantages of granting broad powers to supervisors. Pasiouras, Tanna and Zopounidis (2007) identify the official supervision approach and the private monitoring approach to banking supervision. The official supervision approach argues that official supervisors have the capabilities to avoid market failure by directly overseeing, regulating, and disciplining banks. By contrast, the private monitoring approach argues that powerful supervision might be related to corruption or other factors that impede bank operations, and regulations that promote private monitoring will result in better outcomes for the banking sector. While these two approaches of supervision might reflect different attitudes towards the role of government in monitoring banks, they are not necessarily mutually exclusive (Levine, 2004). Consequently, in practice countries could adopt regulations that force banks to disclose accurate information to the public, while also create powerful official supervisory agencies (Levine, 2004).

According to Barth, Caprio and Levine (2002), banks are costly and difficult to monitor which leads to too little monitoring of banks, which implies sub-optimal performance and stability; official supervision can ameliorate this market failure. They submit that because of informational asymmetries, banks are prone to contagious and socially costly bank runs; supervision in such a situation serves a socially efficient role. Third, many countries choose to adopt deposit insurance schemes. This situation: (1) creates incentives for excessive risk-taking by banks, and (2) reduces the incentives for depositors to monitor banks. Strong, official supervision under such circumstances can help prevent banks from engaging in excessive risk-taking behaviour and thus improve bank development, performance and stability.

CURRENT STATE OF REGULATION AND SUPERVISION IN GHANA

A country's legal framework and governing principles define the roles of its banking and financial sectors and those of the regulatory authorities (such as the central bank), setting out rules for entry and exit of financial institutions, determining and limiting their businesses and products, and specifying criteria and standards for the sound and sustainable operation of the industry (Atuguba and Dowuona-Hammond, 2006). A primary reason for regulating and supervising traditional financial institutions is consumer protection for public depositors in financial institutions. The Bank of Ghana has overall supervisory and regulatory authority in all matters relating to banking and non-banking financial business with the purpose to achieve a sound, efficient banking system in the interest of depositors and other customers of these institutions and the economy as a whole. The Bank of Ghana is therefore, charged with the responsibility of ensuring that the financial system is stable to ensure that it serves as facilitator for wealth creation, economic growth and development.

Legal and Regulatory Framework for Bank Regulation in Ghana

The laws governing banking operations have provisions regarding licensing, withdrawal of license, and arrangement for examining and monitoring banks, powers, and duties as well as protection of the supervisor. The regulatory and legal framework within which banks, operate in Ghana are the following Bank of Ghana Act, 2002 (Act 612), Banking Act, 2004 (Act 673), Companies' Code, 1963 (Act 179), Banking (Amendment) Act, 2007 (Act 738), Bank of Ghana Notices/Directives/Circulars/Regulations (Osakunor, 2009) and ARB Apex Bank Limited Regulations, 2006 (L.I. 1825). To enhance the legal and regulatory framework, the Bank of Ghana supervisory functions are designed to be consistent with the Basel Core Principles for Effective Banking Supervision.

The Banking Act, 2004 (Act 673) imposes a mandatory duty on the Bank of Ghana to revoke the license given to a bank to carry on banking business when the entire capital base of the bank is eroded and the liabilities exceed the assets unless the shareholders are able to inject additional capital to restore the bank to normalcy within six months from the time of the capital erosion (Section 62). To avoid a situation where banks secretly wind up voluntarily to the disadvantage of customers, the law prohibits banks from voluntarily winding up unless the Bank of Ghana has certified in writing that the bank is able to meet its obligations in full to the depositors and creditors as the obligations accrue.

In order that the public and customers are informed of the operations of a bank and its financial position, the Banking Act (Section 81) requires all banks to exhibit at each one of its branches or agencies in a conspicuous place throughout the year, a copy of the last audited financial statements in respect of the operations of the bank; furnish the Bank of Ghana with a copy of its audited financial statements together with the auditor‘s statutory and long form audit reports; and cause the financial statements together with the auditors‘ certificates to be published in a daily newspaper circulating in Ghana.

The Banking Act also guarantees the secrecy of customer information. It provides that a director, an officer or any other employee of a bank shall not disclose information relating to the affairs of a customer with that bank except where the disclosure of the information is required by law or by a court of competent jurisdiction or the Bank of Ghana or is authorized by the customer or is in the interests of that bank (Section 84).

According to Ackah and Asiamah (2014), sustained financial sector restructuring and transformation in Ghana has succeeded in creating one of the most vibrant financial services centers in the sub region. Ghana has, therefore, seen a significant increase in the number of banks, including Pan-African groups, with a rapidly expanding deposit base. Presently, Ghana is a home to 27 banks, of which 15 are foreign-owned and 6 are African banks. According to PwC (2014), the present banking industry is fairly saturated comprising 27 universal banks, 137 rural and community banks, and 58 non-banking financial institutions including finance houses, savings and loans, leasing and mortgage firms.

The Bank of Ghana reviewed upwards the minimum capital required for new banks to operate in the country. New commercial banks are required to have a minimum stated capital of GHS 120m. Existing banks are only required to maintain a stated capital of GHS60m it set previously. The understanding was that existing banks would voluntarily grow their capital to the GHS120m in line with their business. Since then 4 existing banks have moved their capital voluntarily to over GHS120m.

Legal and Regulatory Framework for Non-Bank Financial Institutions in Ghana

IMF (2011) contends that Ghana's non-banking sector has registered rapid growth, but long-term finance remains scarce. The IMF in their Financial Sector Stability Assessment Update on Ghana concluded that players in the financial sector of Ghana exhibit common deficiencies in regulation, supervision, and supporting financial infrastructures. They advised the strengthening of regulation and supervision to ensure the viability of the sector.

The regulatory and legal framework within which non-bank financial institutions as well as forex bureaux operate in Ghana include the Financial Institutions (Non-Bank) Law, 1993 (PNDC Law 328), Companies' Code, 1963 (Act 179), and Bank of Ghana Notices/Directives/Circulars/Regulations (Osakunor, 2009). According to the Information, Documentation and Public Services Department (2009), other non-banking and financial laws include the Anti-Money Laundering Act, 2008 (Act 749); Banking (Amendment) Act, 2007 (Act 738); Borrowers and Lenders Act, 2008 (Act 773); Central Securities Depository Act, 2007 (Act 733); Credit Reporting Act, 2007 (Act 726); Foreign Exchange Act, 2006 (Act 723); Home Mortgage Finance Act, 2008 (Act 770); Non-Bank Financial Institutions Act, 2008 (Act 774).

The Bank of Ghana has also reviewed upwards new capital requirements for other financial institutions. Savings and Loans companies will now be required to have GH¢15 million Cedis as their new minimum capital from the GH¢7 million required earlier. The Rural and Community banks are now required to have a minimum capital of GH¢300, 000 up from GH¢150,000 previously.

Supervision by Bank of Ghana

Overall, macroeconomic developments in Ghana since 2014 have not been impressive in recent times. The Ghanaian economy encountered significant macroeconomic challenges in 2014 due, in part, to high and extraordinary fiscal and current account deficits during 2012-2013. The year 2014 has been extraordinarily difficult for Ghanaians as the Government had to contend with both domestic imbalances, especially in the fiscal area, and severe terms of trade and exchange rate shocks. The growing economic imbalances resulted in heightened financial fragility and uncertain expectations, which led to rapid outflow of capital and increased the probability of a severe crisis as a result of a falling exchange rate and rising interest rate (Ackah and Asiamah, 2014).

Ghana's current account deficit increased to 13.2% of GDP in 2013, from 12.2% of GDP in 2012. By the end of February 2014, Ghana's net international reserves had also declined significantly, covering less than one month of imports of goods and services. Net international reserves fell from US$3.2 billion in December 2012 to $2.1 billion by end 2013 and $1.7 billion by January 2014 covering only less than one month of imports of goods, services and factor payments. Headline inflation exceeded the monetary policy target of 9% ±2 for 2013. The consumer price inflation increased from 10.1% in January 2013 to reach 13.5% in December 2013 and 14.0% in February 2014.

The central bank reacted on February 4, 2014 announcing new measures intended to restore stability in the foreign exchange markets. Under the new rules, commercial banks and other financial houses were banned from issuing cheques and cheque books on foreign exchange accounts and foreign currency accounts. The new measures also provided that all undrawn foreign currency-denominated facilities should be converted into local currency-denominated facilities (Ackah and Asiamah, 2014). The Central Bank also directed that no bank should grant a foreign currency-denominated loan or foreign currency-linked facility to a customer who was not a foreign exchange earner. The central bank also prohibited offshore foreign deals by resident and non-resident companies, including exporters in the country. It also prohibited over-the-counter cash withdrawals from foreign exchange and foreign currency accounts not exceeding US$10,000 or its equivalent in convertible currency per person per travel, and that this should only be permitted for travel purposes outside Ghana. These measures were introduced following pressure on the local currency, which depreciated sharply within the first few months of 2014.

However, in spite of these measures, the local currency continued to depreciate against all the major foreign currencies. Many policy analysts and the business community found the reaction of the central bank somewhat perplexing given that the underlying drivers of the instability were quite not unfamiliar in Ghana’s recent economic history. As it became apparent that the measures were not working optimally and the business community continued to express their frustrations about the foreign exchange restrictions, the central bank decided to relax some of the restrictions and later had to withdraw them entirely.

Although the Ghanaian Cedi continued to fall after the Central Bank had introduced the exchange rate restrictions – between January and September 2014, the Cedi had fallen by about 40% against the US dollar - the currency has stabilised after the infusion of $2.7 billion into the economy through a US$1 billion Eurobond floatation and $1.7 billion cocoa syndicated loan facility (Ackah and Asiamah, 2014). The government finalized a negotiation with the IMF for an economic reform and bailout package, a process which inspired some confidence in the economy as investors expected that an agreement could help stabilise the economy, which had been growing for the past few years on the back of its export of cocoa, gold and oil. The first tranche of amount has been released by IMF under the agreement.

During the year the regulator strengthened its supervision of these non-bank financial institutions. This led to the closure of those institutions which did not meet the regulatory requirements. The minimum capital for the deposit and non -deposit taking micro-finance institutions was raised in August 2013 to GHS 300,000 and GHS 500,000 respectively. The capital requirement increases up to an additional GHS200,000 for institutions with over 5 branches. Primary liquidity reserves have been set at 10% of total deposits. The application of technological innovation aimed at improving delivery systems in the country has been embraced within the industry. The Bank of Ghana in May 2013 launched the collateral registry aimed at streamlining the credit delivery system in the country. This will ease challenges in perfection of securities and its realisation in the event of default. During the year in review, another technological innovation announced was the development of the gh-link mobile by Ghana Interbank Payment and Settlement System (GhIPSS) in collaboration with Nigerian payment company eTranzact. The introduction is part of GhIPSS’ mandate to transform Ghana into an electronic payment society.

In line with the Bank’s objective of ensuring the safety, soundness and stability of the entire financial system, the Bank in January 2011, set up a microfinance office within the Banking Supervision Department to regulate and supervise microfinance institutions. In July

2011, the Bank issued operating rules and guidelines on microfinance for the information of the general public and for compliance by operators in the micro-finance sub-sector with the view to sanitizing their operations and safeguard the interest of their patrons. The rules and guidelines dealt with categorization of microfinance institutions into tiers, defined permissible activities, stipulated minimum paid-up capital and other licensing requirements.

CONCLUSION AND RECOMMENDATIONS

The global financial crisis of 2008-2009 and the subsequent U.S. Federal Reserve's "tapering announcement" in May 2013, which contributed to capital outflows from some sub- Saharan African frontier markets and exchange rate depreciations, are clear testaments of how imbalances and instabilities in the macro economy create instabilities in financial markets and real sector growth slippages. It is, therefore, of utmost importance to keep a watchful eye on risks or threats to stability in the macroeconomic and financial environments before these can metamorphose into a real crisis situation.

In Ghana, sustained financial sector restructuring and transformation has succeeded in creating one of the most vibrant financial services centres in the sub region. The liberalization of the sector coupled with the introduction of "universal banking" in 2003 led to an influx of foreign banks and investors. Certainly, these investments were apparently driven by good economic policies and profit opportunities as well as prudential banking supervision, rather than market size. The pace of financial sector development has been strong and the sector continues to attract a lot of foreign direct investment, especially from other regional banks. The central bank has therefore continued to fine-tune its regulatory regime to stem cross-border risks to the financial sector, while providing room for the financial sector to thrive and play its expected role in enhancing economic growth and development.

The regulatory and supervisory regime in Ghana has evolved over the years to meet the changing structure of the Ghanaian financial industry as well as the risk levels associated with the pace of expansion. These prudential regulations relating to banking and non-banking financial business aim at achieving a sound and efficient banking system in the interest of depositors and other customers of these institutions and the economy as a whole. However, there remain cross-cutting challenges that need to be addressed. It is recommended that the Bank of Ghana, as the central bank with an overall supervisory and regulatory authority in all matters relating to banking business in Ghana, continues to ensure a sound, competitive and efficient financial system.

Finally, it is recommended that further studies are conducted to investigate how the Bank of Ghana incorporates the recommendations made under the Basel Accords, specifically, Basel III in the regulatory and supervisory framework of the financial sector of Ghana. Other studies should specifically target the regulation and supervision of only non-banking financial institutions since the area seems neglected in the literature.

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