RESEARCH BY: SALMAN PARTNERS AND FINANCIAL CONSULT LTD

FINANCIAL DISTRESS AND BANK FAILURES IN GHANAIAN BANKING SYSTEM.

(LESSONS FROM THE DISSOLUTION OF UT BANK AND CAPITAL BANK)

1) INTRODUCTION AND BACKGROUND

Financial institutions are very important in any economy as they mobilize savings for productive investments and facilitating capital flows to various sectors in the economy, thus stimulating investments and increase productivity (DFID, 2004). In most of the developing countries, the main financial institutions in the economy are the banks and they are the dominant. They are also main mobilizers of funds, providers of risk management services and financiers of small, medium and large-scale enterprises and government. It is through them that finance makes its major contributions to

sustained economic growth development and stability of the country. Banks also play an important role in ensuring an efficient and effective payment system and transaction processing. While playing the foregoing role, the banking industry is also the medium through which monetary policies are implemented the central banks. Banks play a critical role in the emerging economies where most borrowers have no access to developed capital markets (Greuning and Bratonovic, 2003).

The health of the banks as well as the entire financial sector are very important as failure in financial intermediation can critically disrupt the economic development process (Rajaraman and Vasishtha, 2002). Well-functioning - banking system support economic growth and development, while poorly functioning banking system impede economic growth and exacerbate poverty (Barth, Caprio, and Levine, 2001). Banking crises are particularly harmful for the economy and detrimental for the health of financial sector. Its fiscal burden is only a distribution of resources within the economy. But the real cost of banking failure is the dead weight loss and consequent in macroeconomic policy forced by the crisis.

Over the years, there has been increased number of significant bank failures in both developed as well as developing economies (Brownbridge, 1998; OECD, 2009; BIS, 2004). Bank problems, mostly financial distresses and

bank failures have afflicted many countries, of which many have been closed down by the regulatory authorities (Brownbridge, 1998). In the 2007-2008 global financial crises, two financial institutions Lehman Brothers and Wachova were closed down by the US regulators. This in turn led to contraction of activities, decline in output and imposition of substantial costs on the economy. Studies in other countries showed that most financial distress and bank failures were caused by huge non-performing loans (Brownbridge, 1998). Economic downturn, insider lending, connected lending, political exposed persons, customer failure to disclose vital information during the loan application process, poor credit administration procedures among other factors have been identified in many countries as the main causes of high non-performing loans for financial distresses and failures (Santomero, 1997; Brownbridge and Harvey, 1998).

The impact of bank failures has far-reaching consequences for stakeholders, both directly and indirectly. Shareholders are one of the many stakeholders in a company standing to lose the value of their investment deteriorates or potentially disappears entirely. Creditors may receive partial or no repayment of their initial loans advanced to the company, depending on whether their loans were secured or unsecured. The implication of a company failure is unfortunately not that simplistic and has serious

consequences for many other stakeholders. To highlight a few, employees lose their jobs, the Government collects less company and employee taxes, and in addition, has to allocate additional funds to support the unemployed, in general affecting existing taxpayers. In the banking industry, in the absence of deposit insurance scheme or the government deposit protection scheme, depositors and customers may the chance of losing their funds in the collapse of any bank.

To establish a bank's financial health, stakeholders rely on published information to formulate decisions relevant to them. Investors rely on published financial statements or stockbroker reports and the daily press. Creditors rely on financial models to predict potential bank failures. Each of these stakeholders uses the information in one or the other financial distress or failure prediction model to support their decision- making process. Some of these models are more sophisticated than others. Irrespective of a stakeholder's objective, the early prediction of company financial distress or failure is essential to protect their interests.

Financial distress and bank failures are phenomenon involves poor liquidity, undercapitalization, maturity obligations of deposits, excessive growth and lack of regulation and supervision. No country could be said to be insulated from the wave of financial sector crisis in the 1990s and 2000s. It has been

reported that two- third of member countries of the International Monetary Fund (IMF) both developed and developing country members had significant banking problems. The extent of the banking distresses and failures in Ghana compared with other countries (Benin, 1988-1999: 17% of GDP); Nigeria, 1989-1995: 2%of GDP; Cote D'ivoire 1988-1991, 52% of GDP; Japan 1985-1988, 4.7% of GDP; USA 1981-1991, 3.2% of GDP) World Bank development report 1996). According to Leaven and Valencia (2012), the 2007/2008 global financial crisis which started with the collapse of sub-prime residential mortgage market in US, brought significant cost (median fiscal cost of 5.9% of GDP) and median output loss of 24.8% of GDP) on the advanced economies. In addition to these costs, due to contagion effect, a number of financial institutions ranging from Lehman Brothers, Wachovia and Citi group in USA, Bankia and Dexia in Europe were distressed and failed, even if they were rated as well as well-capitalized on the day they failed, got bailed out or were acquired (Bulow & Klemper, 2013).

It is well known fact that the Ghanaian banking between 1980-1989 witnessed unprecedented level of financial distress, as reflected in the large volume of non-performing loans, insolvency, liquidity problems, defaults in meeting depositors demand and inter-bank market obligations. There has always been a debate about major causes of financial distress and bank

failures in Ghana, while bankers usually blame distresses and failures on external factors such as inappropriate government monetary and fiscal policies, government failure to pay arrears to road contractors, Bulk Distribution Companies, SOEs such as VRA, Electricity Company of Ghana, Gridco and Tema Oil Refinery, and other service providers while the regulator such as Bank of Ghana attributes bank distress and failures to ineffective board oversight, poor credit practices, weak risk management practice and mismanagement and depositors invariably blame weaknesses in regulation and supervision and poor enforcement practices on the part of the regulator.

However, the identification of principal factors that contributes the wide spread financial distress and failures are usually theoretical and empirical issues. The phenomenon surfaced in the Ghanaian banking system in 1989 where five public sector banks that were distressed while two banks failed in the 1990s. A study by World Bank (1987) showed that five public sector banks were financial distressed as a result of huge non-performing loans while two development financial institutions were liquidated as a result of non-performing loans. All five banks and two development finance institution were rendered insolvent by non-performing assets and had to be restructured in 1989-1991 of total C 62 billion or US$ 170 million or 4.4% of

1989 GDP. The main reason for the distressed banks was that they were pressured into extending finance to unbankable projects to meet developmental and political objectives. The distressed banks were very vulnerable to political pressure because the government had authority to appoint and dismiss the banks' executives and managers. The economic crisis and radical changes in economic policy implemented during the 1990s also contributed to deterioration in the banks' asset portfolios. Some of the projects financed by banks were closed down because foreign exchange to purchase inputs was unavailable. Many importers to whom letters of credit were extended by the commercial banks were unable to meet their obligations following the large exchange rate devaluations which began in 1983 (Brownbridge and Gockel, 1987).

One single most important system of bank failures in Ghana is characterized by poor credit risk management has been non-performing loans. In practice, over the past decade, some Ghanaian banks did show the signs of financial distress which had resulted in the dissolution of UT Bank and Capital Bank by the Bank of Ghana in 2017. The question is why did some of the Ghanaian banks become financially distressed, that resulted in the failure of two banks. To what extent the causes of financial distresses and failures identified are relevant for the banking sector. What lessons can be learned by all

stakeholders in the Ghanaian banking industry from those episodes. These and other related questions are important for academics and policy makers.

To best of our knowledge, however, there has been no systematic study or analysis on financial distress and bank failures in Ghana. This is an attempt to fill this gap. This paper tries to bring forth some lessons for all stakeholders such as regulator, depositors, bankers and shareholders in the Ghanaian banking industry. In the absence of any standard technique to identify the causes of financial distress and bank failure from a limited amount of data afforded by case study, we have adopted a "listing approach" whereby we first list all plausible causes of financial distress and bank failure identified in various studies in the context of other countries and relate them to how, why and to what extent they are relevant for Ghanaian banking industry. This will provide us framework for evaluation. The analysis of the role of each of these factors in the context of financial distress and bank failures with particular reference to the dissolution of UT Bank and Capital Bank that will then provide us some lessons for the strengthening the Ghanaian banking industry.

2 (i) Financial Distress

Financial distress is the situation when a bank cannot meet or face difficulty to repay off its financial obligations to the creditors. The chances of causing financial distress increases when fixed costs are high, assets are illiquid, or revenues that are too sensitive to economic recessions. Bank financial distress can be described as a situation where the bank experiences a cash flow constraint, for one reason or another. This constraint or cash flow shortfall can be of a temporary nature, provided that bank management has the capability and ability to take timely corrective action. An example of corrective action is to negotiate an increased or bridging funding facility without it necessarily having a negative impact on its longer- term gearing. Financial distress can be sub-divided into four intervals: deterioration of performance; failure; insolvency and default. Whereas failure affect the profitability of the bank, insolvency, and default are rooted in its liquidity. Theoretically, the outcome of each interval can be positive, implying that the bank breaks the downward trend, or negative indicating the continuing deterioration of the bank value and a movement downwards from one sub-interval of the spiral to another. The bank's inability to honor its immediate debt obligation, implying commercial insolvency, can ultimately result in the bank becoming factually insolvent where its total liabilities exceed its total assets.

(2ii) Bank Failure

Bank financial failure or factual insolvency results in the company's affairs being wound up, whereby its assets are sold in execution and the net proceeds, if any, distributed amongst creditors. Those creditors who have submitted claims against the insolvent estate could receive a liquidation dividend, partly or in full repayment of their claims. This, however, is dependent on the ranking amongst the creditors – a secured creditor has a higher ranking than a preferential creditor, who in turn is ranked higher than an unsecured or concurrent creditor. The process where a company experiences financial distress over the short term and progresses over time into a situation of imminent failure is best demonstrated on a financial distress continuum.

(2iii) Financial Distress Continuum

On a distress continuum (Cybinski 2001), financial distress can be of a temporary nature at the one end, or over time become more of a permanent nature at the other end. Temporary financial distress could potentially be the result of several factors. On the one hand, for example, delayed payment by a major debtor or the temporary suspension of an off -take agreement. On the other hand, the company may have concluded a major new contract

and experience temporary cash flow constraints due to the mismatching of working capital components during the project start-up phase. Long term financial distress may inevitably lead to the company failing and its affairs being wound up. On the distress continuum, early detection of financial distress is crucial as it could potentially increase the likelihood of returning the company to financial health. The chances of returning the company to financial health diminish over time if inappropriate or no action is taken to remedy the distress situation.

3) Theories on causes of financial distress and bank failures

This section analyses and reviews the theories on some of the factors behind bank distress and failures. It is very useful for all stakeholders including regulators, government, academics, and researchers in the banking sector to know what causes a bank distress in order to prevent the failure. Banking failures are particularly harmful for the economy and detrimental for the health of financial sector. Its fiscal burden is only a redistribution of resources within the economy. But the real cost of banking failure is dead weight loss and the consequent diversion in macroeconomic policy forced by the failure. The issue acquires another significance in the context of banking, as it can potentially inflict reputation damage to the nascent industry.

The literature on financial distresses and bank failures identify that banking structure is inherently unstable and therefore, itself contributes to the occurrence of crisis (Diamond & Dybvig,1983; Bryant,1980). Being a deposit taking institution, the liabilities of a bank, at a given point in time, are fixed and a fixed interest is promised on them, whereas its assets are in the form of loans earning variable interest and subject to credit risk. This also leads to interest rate risk. Similarly, its demand deposits by nature are of shorter maturity while its loans are for longer duration. Therefore, there always exist a risk of maturity mismatch. These features of the assets and liabilities render the banking sector prone to crisis in the wake of any shock, or decreased confidence of the depositors. The literature on financial distress and bank failure can be attributed to both exogenous and endogenous factors, and endogenous factors include managerial ineptitude, insider abuses and malpractices, meddlesome interference by principal shareholders, weak internal control systems undercapitalization and so on. The exogenous factors include macroeconomic instability, regulatory weaknesses and policy induced shocks. There is a vast of literature comprising of competing theories on macro and micro level causes of financial distress and bank failure. Caprio and Klingebiel (1996) point out that micro economic factors can be divided between (i) what is internal to the bank and (ii) what is external

to the bank, which includes the banking environment, regulatory factors and behavior of bank customers. Lower (1997) provided a list of both internal and external factors. Lower (1997) suggest that internal factors include poor business model and strategy, poor credit risk assessment, concentrated lending and excessive risk taking, connected or related lending, entering into new business lines, internal control failures and other operational failures. Lower (1997) also provided a list of external factors to the bank such as inadequate supervision and weak enforcement, regulatory forbearance, inadequate infrastructure, financial deregulation policies, weak accounting standard practices and poor disclosures and inefficient external audit practices. Macro-economic factors include persistent budget deficits, high inflation and high interest rates, currency depreciation and deterioration of terms of trade.

The issue especially concerns board of directors, senior management and regulators are also be considered as micro factors that could affect the distress and bank failure. This is because most directors and senior management are sanctioned and punished in some jurisdictions while in the other jurisdictions such as Ghana both directors and senior managers go scot free. For regulators are blamed whenever there are bank distresses and failures. It is therefore for all stakeholders to understand the theoretical

underpinning for the causes of bank distress and failure in order to help them to prevent crisis. Furthermore, the economic and social costs of bank failure could be high especially in the absence of robust deposit protection or insurance scheme. The social costs of a bank failure could be bigger than the economic costs incurred by the failed bank. The consumers could lose confidence in the entire financial system. There is a vast literature comprising of competing theories on macro and micro level causes of bank distress and failures.

One notable cause that has contributed to the spate of financial distress and bank failures globally has been the issue of bad loans. According to Michael et al (2006) opined that asset quality is a critical determinant of sound functioning of the banking system. Risk assets can turn into non-performing loans when borrowers default on their repayment of both the interest and principal on maturity date. Asset quality impairment is caused by several reasons. According to Misra and Dahl (2010), unusual business cycle is a primary reason for most banks' non-performing assets. Kent and Davcy (2000) argued that the potential for banks to experience substantial losses on their loan portfolio increases towards the peak of the expansionary phase of the cycle. However, towards, the top of the cycle, banks appear to be relatively health, when the quality of non-performing loans are satisfactory

and profits are high, reflecting the fact that even the riskiest of borrowers tend to benefit from buoyant economic conditions. While the risk inherent in bank lending portfolio peaks at the top of business cycle, this tends to be realized during contraction phase of the business cycle. As the banks' non-performing loan increases, profit declines and substantial losses to capital may negatively affect the capital adequacy. De Bock and Demyanets (2012) averred that the herds of behavior of bank managers can lead to a deterioration of credit standards during economic booms, as credit mistakes are judged more leniently. Gopalakrishnan (2005) submits that the causes of non -performing loans can be classified into political, economic, social and technological reasons. He observed that the neglect of proper credit appraisal, lack of monitoring and follow-up, poor credit administration, recessional pressures in the economy, change of government's monetary and fiscal policies, and diversion of funds are some of the major causes of non-performing loans which could ultimately cause financial distress and bank failures.

Reddy (2002), however, notes that the problem of non-performing loans are not mainly because of lack of strict prudential norms, but due to legal impediments and time- consuming nature of assets disposal process, postponement of the problem by the banks to show higher returns on assets

and manipulation by debtors using political influence. A study by Aggarwal and Mittal (2012) noted that improper selection of borrowers' activities, weak credit appraisal system, industrial problems inefficient management, slackness in the credit management and monitoring, lack of proper follow up are major reasons for high non-performing loans. Non-performing loans affect the operational efficiency which impacts negatively profitability, liquidity and solvency positions of the banks. Non-performing assets generate a vicious cycle of effect on the sustainability and growth of the banking system and if not managed properly could lead to both financial distress and ultimately bank failures.

Another cause that had contributed to financial distress and bank failure in Africa was lending, at high interest rates, to borrowers in high risk segments of the credit market. This involves an element of moral hazard on the part of both domestic private banks and their borrowers and adverse selection of the borrower (Brownbridge, 1998). It was in part motivated by the high cost of mobilizing funds. Because they were perceived by depositors as being less safe than the established banks, the newly domestic private banks had to offer depositors higher deposit rates. They also had difficulty in attracting non-interest bearing current accounts because they could offer few advantages to current account holders which could not also be obtained from

the well -established banks. Some of the domestic private banks relied heavily on high cost inter-bank borrowings from other banks. The high cost of funds means that the domestic private banks had to generate high earnings from their risk assets, for example, by charging high lending rates, with consequences on the quality of their loan portfolios.

The local banks in Africa almost inevitably suffered from adverse selection of their borrowers, many of who had been rejected by the well established foreign banks, because they did not meet the strict creditworthiness criteria demanded of them (Brownbridge, 1998). Brownbridge stated that the problem for many of the failed banks was that they served the high- risk segment, where they did not have adequate expertise to screen and monitor their borrowers and therefore could not distinguish between good and bad risk. In addition, credit procedures such as the documentation of loans, and securities or collaterals and internal controls, were frequently very poor. Managers and directors of the failed banks often lacked the necessary expertise and experience (Mamman and Ouyemi, 1994).

One of the theories attributed to bank failures is the macroeconomic instability while another says regulatory forbearance contributes bank distress and failure. A study by Kindleberger (1989) cited in Hooks (1994) showed that bank failure results from excessive risk taking. Some of the

other theories for causes of bank failure include poor corporate governance practices, weaknesses in regulatory and supervisory framework, uneven supervision and weak enforcement (Palubinskas and Stough (1999). Hempel & Simonson (1999) also posits that mismanagement, regulatory forbearance and the deregulation of the financial sector without strong and robust regulatory and supervisory framework in place could contribute to both bank distress and failure. This section, therefore, attempts to analyze and review some of theories behind the bank distresses and failures.

Macro-economic instability has been one of the theories behind the bank distress and failures globally. Hooks (1994) points out that the deteriorating local economic conditions (e.g. high inflation rate, high interest rates and depreciating exchange rate) cause both financial distresses and bank failures. Goldstein and Turner (2003) noted that macroeconomic instability and volatility can cause banks to be vulnerable if it alters the relationship between the values of bank assets and liabilities. A study by Brownbridge (1998) revealed that periods of high inflation occurred in four African countries covered in the study. He noted that a high inflation rate was largely responsible for the volatility of business profits which could affect the repayment of loans because of its unpredictability, coupled with high degree of variability in the rate of increase of the prices of particular good and

services which constituted the overall price index. This observation underscores factors of adverse selection and poor incentives for borrowers to take risks, and inevitably, account for high probability of loan default. In addition, a high inflation rate makes loan appraisals are very difficult for banks, especially as the variability of potential borrowers depend on unpredictable developments in inflation, exchange and interest rates. High budget deficits and persistent inflation have been two of the intractable problems that have confronted and inhibited the growth and development of the emerging economies. It has been recognized in the literature that precarious macroeconomic conditions are themselves a potential source of financial crisis even for otherwise sound banking system.

Poor credit practices and concentrated risk have been major causes for bank distress and failures. Simonson (1999) state that the main activity of bank management is about deposit mobilization and granting credit. Effective credit appraisal, evaluation and administration reduces the customer default. The competitive advantage of a bank is dependent on its capacity to handle credit risk professionally, as huge non-performing loans causes both financial distress and ultimately failure. Palubinskas and Stough (1994) note that failure of bank is mainly seen as a result of mismanagement because of bad credit decisions made with respect to wrong appraisal of credit status,

or the repayment of non-performing loans and excessive focus on giving loans to high risk customers. Goodhart et al (1998) also state poor credit control, which results in undue credit risks cause bank distress and failure. Chemerine (1998) adds that bad lending traditionally leads to a large portfolio of non-performing assets. This results in insolvency of banks and reduces funds available for fresh loans and other credits which eventually cause a financial crisis. Goodhart et al (1998) posit that connected or related lending. Again, Palubinskas and Stough (1999) note that lack of dependable financial information on borrowers to help in assessing creditworthiness cause a bank failure.

One major stream of the literature emphasizes that the main cause of financial distress and bank failure rests on bad management practices, reflected in the deterioration of banks' credit portfolio and capital structure. Ooghie & Prijcker (2008) pointed out that the cause of corporate distresses or failures had the characteristics of mismanagement (e.g. inappropriate management qualities, poor skills, lack of expertise and experience, bad business models and poor corporate strategies). Scherrer (2003) noted that often management does not recognize the internal signs of failure and blame external factors for their business failure. Poor management continues as one of major causes for both financial distress and bank failures in the

emerging economies especially with state own banks and private domestic banks. Some of these banks were characterized by inept management and instability in the tenure of key management staff. Negative culture of interpersonal wrangling among top management staff lead to polarization of the rank and file of the staff. Board members and senior managers in most of these banks embarked on empire building and tunneling at the expense of the shareholders.

According to the study by Brownbridge (1998), posits that one single biggest contributor to bad loans of many failed local banks in Africa was insider lending or related lending by some senior management and board members. The threat posed by insider lending or connected lending to the soundness of the banks was exacerbated because many insider lending and connected lending invested in the speculative projects such as real estate development, breached the single obligor limits and were extended to projects which could not generate short term returns, with the result that the maturities of the bank's assets and liabilities were imprudently mismatch. Bank failures mostly come from the absence of good managerial ideas in the decision - making process. Therefore, competence, skills, experience and focus play major role in the banking business (Spiegel et al, 1990). According to Pantalone & Platt (1987) cited by Hooks (1994), mismanagement, especially

excessive risk-taking is the main cause of bank distress and failures. Spollen (1997) cited the following as underlying causes for business failure: (i) inability of management to appreciate and understand the business model or strategy, (ii) inability of management to ensure compliance with laid down procedures and regulation. Goodhart et al, (1998) posit that if worker compensation is tied to performance and output is below expectation, the managers could manipulate the output for fear of being dismissed. This risky behavior could eventually lead to the collapse of bank (e.g. Barings Bank failure). Palubinskas & Stough (1999) stated that the shortages of professional bankers and accountants regarding the loan appraisals, scrutinize of financial information of the borrowers, poor appraisal of cashflows or calculation of fundamental of profitability contribute to many loan defaults that impacted negatively on capital requirements of banks.

The primary reserve requirement is a portion of cash to total deposits which banks are obliged to maintain with central bank. White (1999) adds that a central bank obliges commercial banks to reserve the fund in order to help the cheque clearing system as well as improve the actual need for base money. Friedman (1960) cited by Hook (1994) states that bank failures arise because banks do not keep enough of their deposits in statutory reserve funds. Seligin (1996) and White (1999) state that central banks use the

lender of last resort mechanism to help to help some banks. Nier (2009) opined that in the central banks capacity as lender of last resort, central banks have traditionally extended credit to individual banks who see an outflow of liquidity and are unable to finance this interbank money markets. The experience also highlights how- as an extension of their role of lender of last resort – central banks tend to become involved in the resolution of individual systemically important institutions that are particular liquidity stress. This includes important deposit takers (e.g. Northern Rock UK), but can go beyond this class to take in those institutions whose failure is disruptive to broader financial market (e.g. Bear Stearns and US AIG). It is now become more widely accepted that a central bank's de-facto role as lender of last resort and as agent in the resolution of systemically important financial institutions may delay the action of closing down the distressed institutions. The prolonged forbearance might be more expensive in the longer run for the government. When bank failure arises, any money reserved to deal with the situation decreases. The only option then is to either replenish the reserves or combines the operations of distressed banks. However, if prospective beneficiaries of this facility perceive that the central bank may intervene when every bank fails, the measure could rather encourage banks to engage in more risky activities.

Banks generally have incentives to engage in excessive risk-taking and speculative activities as long as they guarantee that their failure will not threaten their shareholders and managers. This guarantee is provided by deposit insurance, implicit or explicit guarantees for bail out by government and through easy access to the lender of last resort (Akyuz. 1993). Deposit insurance, which is a scheme particularly observed in both developing and developed countries and designed to protect depositors and attract funds to the banks, provides a kind of guarantee that financial institutions would not be allowed to go broke, and or government bail outs would protect them. Then, banks having this guarantee, being obliged to pay very little attention for insurance coverage, may have the incentives to channel funds into high return, high risk and speculative projects and be illiquid (Akyuz, 1993). These incentives provided by deposit insurance system stimulate excessive risk-taking by banks in the presence of weak regulation and poor supervision, either is designed or enforcement or both, such, that the levels of bank capital and provisions for loan losses because of inadequate supervision. Dermiguc -Kunt and Detraigche (2000) found that the presence of an explicit deposit insurance scheme tends to increase the probability of systemic banking problems.

Control failure refers to the failure in corporate governance practices and lack of internal checks and balances contributed to financial distress and bank failure. It arises when decisioning make is too much centralized, when there is a “rubber stamp or yes men” board of directors, when some board members are ignorant of financial and economic facts and working of the bank, when some board members are not motivated, when the bank staff lack the relevant experience, skills and training and when things are done on trust without proper systems of internal controls.

Weakness of the regulation and supervision of the financial system is viewed as a major factor, contributing to the emergence of bank failures (Fischer and Reisen, 1992: Noy, 2004; Mishkin, 2001:) and financial crisis. It is argued that if financial liberalization is accompanied with weak prudential supervision of the banking sector, then resulted in excessive risk taking by financial intermediaries and a subsequent crisis (Demirgüç-Kunt and Detradiache, 1998; Edwards, 2000; Rossi, 1999; Mehrez and Kaufmann, 2000). Analogous to these arguments, weak regulation and supervision has been held at least partly responsible for leading to crises in countries ranging from the United States and Japan, to Korea and Mexico, Chile, Thailand on the one hand, to India, Russia, Ghana and Hungary, on the other (Barth et al., 1999a). The most striking and strong arguments in this context have been

raised for the Asian banking crisis. It is asserted that it would have been possible to avoid the Asian crisis, if banks had been supervised well (Williamson, 1999; Intal et al. 2001). Mishkin (2001) provides support for this thesis by arguing that the banking non-crisis countries in East Asia, which are Singapore, Hong Kong and Taiwan, had very strong prudential supervision. Corbett, Irwin and Vines (1999) claim that vulnerability to crisis in Asia was created by “liberalization of both trade and financial markets in the presence of an unreformed financial system”.

In most emerging economies, however, inadequate regulation has permitted risky lending and ineffective supervision has permitted banks to ignore their losses. For want of timely and reliable accounting information, regulatory authorities lack a clear picture of the health of banks under their supervision. Effective supervision is particularly important in financial deregulation in the developing economies because newly deregulated financial institutions are likely to engage in less familiar, and therefore more risky types of lending. It is argued that the combination of financial liberalization and inadequate supervision proved costly in the case of the US Savings and loan companies in the late 1980s and early 1990s. Furthermore, a cross-country comparison conducted by Williamson and Mahar (1998) concludes that prudential regulation and supervision was

stronger in countries experiencing less severe financial crisis as compared to those experiencing a more severe crisis. Besides, average level of prudential regulation and supervision in the five-year period preceding a crisis is found not to be independent from the occurrence of a banking crisis.

While weakness of the banking sector, of course, is not the only element that generates vulnerability to economic crisis, banking regulation and supervision emerges as a major component of vulnerability to crisis. It is argued that as capital account liberalization intensifies capital mobility, this imposes a greater burden on a country to assure that its financial system is well supervised and regulated (Dornbusch, 1998). It is asserted that strong banking systems can better handle reversals in capital flows, while weak and inefficient banking systems are less able to cope with volatile capital flows, therefore, are more vulnerable to contagion (Johnston, 1998:5; Johnston et al., 1997). This means that they are more likely to propagate and magnify the effects of financial crises on other economies. Furthermore, it is claimed that concerns about banking solvency or inadequate regulatory frameworks may encourage capital flight. While an extensive literature is devoted in explaining reasons and consequences of financial, mostly banking, crises, reforms proposed to help preventing crises mostly include changes in existing financial regulations and supervisory standards. There exists a long

list of “best practices” for the regulation and supervision of banks, which is proposed by the Bank for International Settlements (BIS) and further extended by the IMF and the World Bank. The underlying phenomenon is the belief that if only policymakers in countries around the world would implement particular regulatory and supervisory practices, then banks would be sound and strong, which would prevent banking crises to great extent.

Hence, almost all international financial institutions, but especially the World Bank and the IMF have begun to urge countries to adopt and implement appropriate regulations and supervisory practices for their financial systems. For instance, Barth et al. (1999b) emphasize that the World Bank stresses the importance of prudential regulation and supervision more than ever in its all financial sector reviews and projects. It is believed that improvements in the existing financial systems will reduce the likelihood of financial instability and crisis. The validity of these assertions and beliefs should be questioned, as there is relatively very little empirical evidence that supports the advice for regulatory and supervisory reforms. For instance, there exist only a few studies that question whether the so-called “best practices” currently being advocated by international agencies are the best ones for promoting well-functioning banks and whether successful practices in the United States succeed in countries with different institutional and political environments

(Barth et al., 2002). The reason for the absence of adequate empirical evidence in the literature is the lack of detailed cross-country comparisons of financial and regulatory systems for developing countries and the difficulty of obtaining adequate measures to describe the regulatory and supervisory structure. It was only very recently, in 1999, that data on the practices of various financial regulatory and supervisory authorities for a wide range of countries began to be assembled and analyzed.

Hence, the push for the reforming of financial regulation and supervision by international institutions has begun without even the knowledge as to whether or under what circumstances these efforts will be successful (Barth et al., 1999a). Furthermore, advice for banking reforms to prevent banking crises began without sufficient information about the extent to which these regulatory and supervisory reforms increase or decrease the likelihood of a banking crisis. In addition, there is very little knowledge about the appropriate way to reform financial sector regulation and supervision in many countries. In view of the fact that capital requirements and regulatory standards recommended by the Basel Committee are designed for industrial countries, their appropriateness for emerging market countries have been rightly questioned in recent years especially in the face of severe banking failures.

Uneven supervision and inadequate enforcement had also played a significant role in exacerbating the problems associated with both financial distresses and bank failures in developing countries such as Nigeria (Sanusi, 2012). Regulators are ineffective in their oversight responsibilities as well as supervising the changes in the banking industry since the adopting of the universal banking concept in countries such as Ghana and Nigeria. There many instances of weaknesses in the supervision and enforcement processes. For example, bank examinations were not conducted on bank consolidated basis. Enforcement had been the biggest failure among the surveillance processes in the developing countries, despite the supervisors have the powers needed to enforce examination recommendations, however no serious sanctions have not applied against the boards and management of the failed banks. Furthermore, sanctions and penalties had woefully inadequate to ensure compliance. Within the examination cycles between 6 months and 12 months, follow up examinations recommendations are rolled up into the following year's examination. The prevailing view that the banking sector was healthy, a culture of tolerance and acceptance of the status quo and shortage of specialist skills and expertise in the universal banking concept compromised supervision effectiveness (Sanusi, 2010)

Regulatory forbearance is a regulatory policy implemented by the central bank that permit banks and other financial institutions to continue to operate even when their capital is fully or partially depleted. Regulators give banks extended periods of time during which they have to comply with regulatory requirements (by securing new capital funds). This inaction reflects the unwillingness of regulators to close down insolvent or weak banks. Hempel and Simonson (1999) note that some regulatory agencies exercise forbearance. This contribute to bank failures by permitting distressed banks to continue their operations instead of liquidity them. This action aims at assisting bank to make profits. It effect is rather disadvantageous to banks because usually when lack funds and remain in operation their capital situation deteriorates. Banking regulators are responsible for monitoring the banking sector which includes closing down troubled or weak banks. However, regulators do not always choose to close down an unsound bank and instead practice forbearance by allowing the insolvent bank to continue to operate. Although regulators are tasked with the timely resolution of insolvent financial institutions, prior research has documented various reasons why regulators may instead practice forbearance by allowing weak banks to continue operating.

First, forbearance is often discussed as a practical element of the lowest cost solution for dealing with troubled banks. Intervention is costly, and regulators can forbear on a troubled bank to allow the bank time to recover without having to incur these costs (Santomero and Hoffman 1998; Brown and Dinç 2011). For example, the manpower necessary to close a bank constitutes a significant cost to regulators. When the US Federal Deposits Insurance Corporation decides to close a bank, it must send a team of employees to assume the bank's day-to-day operations. Even for small banks, this cost can be quite large: for example, in 2009, the FDIC sent a team of approximately 80 agents to take over the Bank of Clark County, which had only 100 employees (Joffe-Walt 2009). Direct costs can also include bankruptcy costs and lower asset values due to fire sales (Brinkmann et al. 1996). Many of these direct costs are likely heightened during crisis periods (Santomero and Hoffman 1998). However, forbearance can also increase the ultimate cost of resolving the bank, since it creates a moral hazard for bank management (Santomero and Hoffman 1998). Managers at a troubled bank have incentives to increase risk-taking since they do not share in losses but benefit from achieving solvency. The higher risk strategies will likely lead to higher closure costs for the regulator if the bank fails.

Second, some research suggests that forbearance can be a prudent regulatory policy from an overall welfare perspective. The closure of a troubled bank can lead to concerns about the soundness of connected institutions. Allen and Gale (2000) show that an unanticipated liquidity shock (such as the failure of a bank) can cause system-wide contagion, as problems spread from the failed bank to other banks connected through intra-bank lending and borrowing. In the model put forth by Diamond and Rajan (2005), bank failures can be contagious because they shrink the available pool of liquidity, creating or exacerbating aggregate liquidity shortages. Morrison and White (2013) demonstrate that a similar effect can occur when banks are connected by regulator, as the failure of one institution can lead outsiders to lose confidence in other banks supervised by the same regulator. In both cases, regulators can opt to forbear on troubled banks to prevent the liquidity shock or uncertainty from spreading to the rest of the financial sector. Concerns about the general state of the banking sector can also lead regulators to practice forbearance.

Regulators may not be able, nor willing, to close the entire banking sector during a financial crisis (Santomero and Hoffman 1998). Forbearance could therefore be necessary if a large number of banks are insolvent. Brown and Dinç (2011) find that regulators are more likely to practice forbearance during

crisis periods, which they refer to as the Too-big-to-Fail effect. Furthermore, regulators may prefer forbearance if the banking sector's problems begin to threaten the viability of the deposit insurance fund. For example, in the United States, the FDIC have been known to practice forbearance in response to concerns about deposit insurance (Federal Deposit Insurance Corporation 1997; Santomero and Hoffman 1998).

Finally, forbearance may be a result of the principal-agent problem, where regulators (the agent) do not have the same incentives as taxpayers (the principal). For example, the closure of a bank could signal to depositors and the public that the regulator is of low quality (Boot and Thakor 1993). A failed bank could lead to the regulator being blamed for poor performance, and thus by pursuing forbearance regulators can hope the situation will improve to escape culpability (Kane 1989; Mishkin 2000). Regulators also face pressure from politicians, who strongly influence their careers and prefer the appearance of a strong banking sector (Kane 1989; Mishkin 2000; Brown and Dinç 2005). These self-interested concerns will lead the regulator to forgo closing troubled banks, even if bank closure was desirable from the perspective of the taxpayers.

One indicator of a bank's health is its relative level of regulatory capital, which cushions banks against losses from non-payment of loans and other losses

on assets. Regulators require that banks to maintain certain minimum capital requirements to help ensure the safety and soundness of the banking system and generally expects banks to hold capital above the minimum levels commensurate with their risks. Gross under-capitalization constitutes another source of financial distress and bank failures (Kama,2009). Banking sector soundness and its susceptibility to shocks largely depend on the adequacy of its capital. Provisioning for bad loans and other unforeseen losses are absorbed by robust capital, while poor capitalization could lead to the folding up of a bank should the risk of default crystallizes. Polizatto (1998) cited that the lower a bank's capital, the higher the probability of its failure. Goodhart et al (1998) agree with this statement and added as bank's capital as a result of bad loan provisions, the higher its motivation for actions towards survival. This could lead to more excessive risk -taking operations. Therefore, the risk of failure rises with the decline of the bank's capital requirement. Palubinskas and Stough (1999) observe that one of the measures used to stop the increases in the bank failure is to increase the capital requirements for banks. This requirement could compel the shareholders increase their capital through fresh injection, consider possible mergers, acquisitions and takeovers or possibly face liquidation by the central bank or the regulator. According to Polizatto (1998) capital increases

enable banks to cushion losses incurred by the banks. When banks have inadequate capital, they usually conceal the situation for fear of exposing the illiquidity. The shareholders, boards and regulators do not effectively address the capital inadequacy on time, it could result in liquidation or bankruptcy. A similar view on the above has been expressed by Goodhart et al (1998) stated that adequate capital reduces risk taking while insufficient capital motivates banks to engage in excessive risk-taking to survive at all costs.

4). **Overview of the Ghanaian Banking Industry**

The financial sector in Ghana is made up of a wide array of institutions and instruments. It consists of the Bank of Ghana which is the apex financial institution, 33 universal banks, 141 rural and community banks, 37 savings and loan companies, 561 micro-finance companies, finance houses, leasing and hire purchase companies, insurance companies, a stock exchange with 39 listed companies, 23 stock brokerage companies, 3 investment advisors, 145 fund managers, 34 mutual funds, 19 unit trusts, pension funds and provident companies, 500 credit unions and a virile informal financial sector.

The main financial institutions in the Ghanaian economy are the banks. They are the main mobilizers of funds, providers of risk management services and financier of medium and large enterprises and government. It is through them that finance makes its major contribution to sustained economic growth, development and stability in the country. A well- functioning banking industry is essential for economic development of the country. Banks take deposits and use them to lend funds to firms, individuals and government. Banks provide a safe place for economic agents (firms, organizations, individuals) to save money that is not immediately needed. At the same time, they turn around to lend to economic agents with less funds than they need. In this way, banks intermediate between depositors and borrowers and transform short term deposits into longer term loans,

Banks also play an important role in ensuring an efficient and effective payment system and transaction processing. While playing the foregoing role, the banking industry simultaneously serves as the medium through which monetary policy is implemented by the Bank of Ghana. The Ghanaian banking industry is regulated by the following laws: (i) Banks and Specialized Deposit Taking Institution Act 2016 Act 930; Bank of Ghana Act 2002 Act 612 as amended Act 2016 Act 913; Deposit Protection Act 2016 Act 931;

Payment System Act 2003 Act 663; Foreign Exchange Act 2006 Act 726; Borrowers and Lender Act 2008 and Credit Reporting Act 2007.

Ghana's banking industry is dominated by universal banks whose share of the banking assets stood at 85.6% of the total assets in the financial system. (Bank of Ghana annual report, 2016). The number of universal banks has increased from 16 in 2006 to 33 in 2016. Out of the 33 universal banks, 16 were controlled by Ghanaians while the foreign controlled banks stood at 17 as the end of December 2016. The universal banks operated 1341 branches in the ten regions in the country and employed 19977 persons. Also, they operated 1928 ATMs and 6015 POS terminals country wide (Bank of Ghana annual report, 2016). The total assets of banks in Ghana stood at GHc 82.64 billion at the end -December 2016, made up of Cash and bank balances of GHc 22.32 billion; Investment of GHc 22.91 billion; Loans and Advances of GHc 31.23 billion while other assets constituted of GHc 6. 2 billion. The total deposits of the banks amounted to GHc 52.69 billion. According to Bank of Ghana annual reports (2014; 2015; 2016) the Ghanaian banking industry has been generally profitable as manifested in the high return on equity, return on assets and return on earning assets. There has been a decline in profitability over the past three years which emanated from high interest costs, high non-performing loans which led to huge provisioning for bad debt

and high operating costs as a result of high energy costs. Total impaired assets increased by 38. 9% to GHc 6,174 billion at the end December, 2016 which translated into non-performing loan ratio (NPLs) of 17.38%. At the end-December, 2016, the banks remained solvent and generally complied with minimum capital adequacy ratio of 10%. The banks' capital adequacy ratio as at end-December, 2016 was 18% compared with 17.8% in December 2015. According to Bank of Ghana annual report (2016), the banking sector remained liquid, as evidenced by operational liquidity measures. Liquid assets to total deposits improved from 74.3% in 2015 to 84.8% at the end-December, 2016. Also, liquid assets to volatile funds increased to 144% in 2016 from 125.2% in 2015.

4.i) The Solvency, Liquidity, Earnings, Management, Systems and Controls (SLEMSC) rating system in Ghanaian banking supervision over the period 2008-2016.

According to the Bank of Ghana (2017), the primary reason for the revocation of UT Bank and Capital Bank licenses were the fact that they deeply insolvent and illiquid. This implies that their liabilities exceeded their assets, and that put them in a position where they were not able to meet their

obligations as they fall due. It is worth mentioning that these banks performed badly as a per the Bank of Ghana's solvency, liquidity, earnings, management, systems and controls ratings were concerned. Furthermore, for our information these poor performances prevailed for more than three years, which clearly also demonstrated that there were regulatory forbearances on the part of the Bank of Ghana.

In the banking set up, the IMF (2001) developed financial soundness indicators (FIS) for the banking industry which include capital adequacy, asset quality, management soundness, earnings, liquidity as well as market risk sensitivity. According to Ziorklui et al (2001) opine that Bank of Ghana has since 2001 adopted the IMF financial soundness indicators. Bank of Ghana since 2013 has adopted SLEMSC methodology in rating. The Bank of Ghana's examination rating system with acronym "SLEMSC" that is Solvency (capital adequacy, asset quality and risk concentration), Liquidity, Earnings (ROE, ROA and ROEA) Management soundness (Governance & Administration, regulatory compliance), Systems and Controls, and market risk sensitivity.

First, under the Section 23 (1) of the Banking Act 2004 Act 673 requires that all banks maintain Capital Adequacy Ratio of 10% to cover the risk exposures such as credit risk, market risk and operational risk, in order to

absorb the potential losses and protect banking institution's debt holders (US Uniform Financial Institutions Rating, 1997). The average capital adequacy ratio is said to have experienced from 13.6% in 2008 to 18.0% in 2016 (IMF report, 2011; BOG annual report, 2016). The average capital adequacy ratio is well above the Bank of Ghana's regulatory limit of 10%. The significant improvement in the CAR over the period could be attributed to the recapitalization in 2008 and 2013, licensing of new banks, and improved regulation and supervision. The average capital adequacy ratio of 18% in 2016 is in line with peer countries of Nigeria (16.4%), Kenya (18.5%), Tanzania (18.1%) and South Africa (14.5%) (IMF, various reports, 2016). According to Safian et al, (2008), banks from developing countries such as Ghana, needs a strong capital adequacy, because it provides them the strength to withstand banking crisis and also offers depositors better safety net in times of bankruptcy and financial distress conditions. Despite increases in the minimum capital requirements in 2008 and 2013, capital inadequacy continues to be prime factor causing financial distress and bank failures in the banking system. This is because minimum capital requirements had been eroded by high inflation, persistent currency depreciation, high funding costs and huge loan loss provisions.

Furthermore, IMF (2014, 14/129) noted that the Bank of Ghana's stress test conducted in 2014 found that two domestic private banks had negative capital while two thirds (2/3) of all banks operating in Ghana needed additional capital to stay above regulatory minimum capital requirement. According to the Bank of Ghana (2017) UT Bank and Capital Bank failed because of severe impairment of their capital (deficient in capital). This means that they were not adequately capitalized to conduct their banking business. Bank of Ghana's examinations revealed that both UT Bank and Capital Bank had critical deficient levels of capital over reasonable period. However, the studies revealed that UT Bank and Capital Bank incurred persistent losses and were unable to meet the minimum capital adequacy ratio of 10% over a reasonable period. Through- out the period under consideration, the Bank of Ghana pointed out this weakness to the shareholders, board of directors and senior management but they ignored the warnings. The failure to sustain earnings and minimize loan loss provisions, these impacted negatively on capital adequacy ratio that prompted the closure of banks by regulators. Failure to meet so many deadlines, Bank of Ghana had no option but to close down these two distressed banks in 2017. Failure of UT bank and Capital Bank to meet the Bank of Ghana's requirement for fresh injection of capital over the period

between 2013-2016 resulted in the liquidation of the two banks in 2017. Section 23 (1) of the Banking Act 2004 Act 673 provides that a banking institution shall at all times while in operation to maintain a minimum capital adequacy ratio of 10%. The UT Bank and Capital Bank had negative Capital Adequacy Ratio over a reasonable period. The failure of UT Bank and Capital Bank suggests a positive relationship between inadequate capital adequacy ratio and bank failure in conformity with the literature.

Second, The Ghanaian banking sector recorded a high non-performing assets ratio ranging from 7.7% in 2008; 16.2% in 2009; 17.6% in 2010; 14.1% in 2011; 13.2% in 2012; 12.6% in 2013; 11.6% in 2014; 15.1% in 2015; and 17.3% in 2016; averaging13.96% which were relatively higher than those countries in the Sub-Sahara Africa (Nigeria, 9.7%; Kenya 7.5% and Tanzania 8.5%) IMF country reports 2014; 2015;2016). A study by Dermirguc-Kunt and Detriagchie (1998) confirmed that any country whose non-performing loan ratios exceed 10% or where cost of bail out exceeds 2% of GPD could be said to be in banking crisis. From this assertion it could be said that Ghanaian banking system had been in crisis since 2009 to date. However, UT Bank and Capital Bank according to various publications, had poor credit controls, weak credit risk management practices, and poor credit administration practices which resulted in huge bad and doubtful debt

provisions over the period. The huge loan loss provisions for the years under consideration clearly showed that credit management practices were inefficient. Mis-management on the part of boards and senior management also demonstrated the absence of good managerial ideas in credit decision-making and added to these were excessive risk taking in the energy and real estate sectors which caused their business models to failure resulting the close down by the regulator. With huge charge for bad and doubtful debts especially in 2014 and 2015 and subsequent assets quality review worsened the situation in 2016, which was evident that both UT Bank and Capital had mismanaged their credit portfolios. The persistent loan losses provisions caused the demise of the two local banks in 2017. The affected banks' risk absorption capacities were very negative due to erosion of equity by accumulated losses. The twenty (20) largest exposures constituted to 87% and 72% respectively of the total credit portfolios. The failure of UT Bank and Capital Bank to improve on high non-performing loans suggest that there existed a positive relationship between theoretical literature and bank failure.

Third, management soundness is basically the capability of the board of directors and senior management ability to identify, measure and control the risks of an institution's activities and to ensure the safe, sound and efficient operation in compliance with the applicable banking laws and regulations

(US uniform financial institutions rating system, 1997). The management of banks could be based on three key financial indicators such as total asset growth, loan and advance growth and earnings growth. The total assets of banks had grown from GHc 10.3 million in 2008 to GHc 13.5 million in 2009, to GHc 17.4 million in 2010, to GHc 19.930 in 2011, to 25,5755 million in 2012, to GHc 34,324 million in 2013, to GHc 45,303 million in 2014, to GHc 63,303 million in 2015 and to GHc 82, 644 million in 2016 (FINSSP 11, 2012; Bank of Ghana annual report, 2016) indicating tremendous growth in the banks' assets over period under review. Management of banks were also assessed on the growth of loans and advances over the period 2008-2016. Total loans and advances amounted to GHc 5.71 billion in 2008; GHc 6.34 billion in 2009; GHc 8.7405 billion in 2010; GHc 10.66 billion in 2011; GHc 11.685 billion in 2012; GHc 15.442 billion in 2013; GHc 22.21billion in 2014; GHc 27.094 billion in 2015 and GHc 31.973 billion in 2016 indicating about 460% growth over the period. In the context of management of the banks it could be said the board of directors and management were very effective as far as the growth of total assets and loans and advances were concerned. Despite the overall growth in the banking assets and loans, for the UT Bank and Capital Bank, the quality of the credit portfolio deteriorated during the review period that resulted in the collapsed of these local banks in 2017.

Addison (2017) stated that one of the reasons for the dissolution of the UT Bank and Capital Bank was that shareholders exerted undue influence on management of the banks on their credit delivery processes which resulted in huge non-performing loans. These affected banks were over-exposed to all its loan customers as a result of its negative net worth. The members of board were well diversified drawn from business background, but their qualification and experience in banking and finance were inadequate. Board met regularly but their deliberations and attendance were not satisfactory. However, though the executive management had the necessary qualification, they were not very experienced to manage these institutions as seen in the numerous concerns raised by the Bank of Ghana's examinations. Misreporting and inaccuracies in the Balance Sheets submitted in EFASS confirmed weaknesses in the management. The failure of UT Bank and Capital Bank suggests a positive relationship between mismanagement and financial distress and bank failure is in conformity with the literature.

Fourth, the Ghanaian banking industry has been relatively profitable over the period under consideration. Most of the banks were profitable in the past nine years, only few banks have recorded losses in those years. Bank of Ghana's rating reflects not only the quantity and trend in earnings but also factors that affect the sustainability of earnings. The Bank of Ghana's profitability ratios

measure the ability of a bank to generate profits from revenue assets. The earnings ratios are the cost to income ratio, net interest margins, return on assets, return on equity and return on earning assets. The relative profitability of the banking industry was manifested in the return on equity. The return on equity was 30.1% in 2008; 23.1% in 2009; 28.64% in 2010; 27.2% in 2011; 19.7% in 2012; 25.5% in 2013; 32.3% in 2014; 21.4% in 2015 and 17.3% in 2016 while the banking sector recorded return on assets ratio of 3,2% in 2008; 2.8% in 2009; 3.8% in 2010; 3,9% in 2011; 3.8% in 2012; 4.8% in 2013; 6.4% in 2014; 4.5% in 2015 and 3.8% in 2016 (Various IMF reports 2008-2016; Bank of Ghana reports 2012-2016). The industry's return on earning assets was 5.3% in 2012; 6.5% in 2013; 8.6% in 2014; 6.1% in 2015 and 5.1% in 2016 (Bank of Ghana report, 2016). The profitability of the banks had declined as shown in the key financial indicators above. The reduction resulted from high interest costs, high non-performing loans over the years under consideration, which led to high provisioning for bad debts and high operating costs as a result of the energy supply short falls (Bank of Ghana report 2016; IMF reports 2011;2012; 2013; 2014 and 2015).

Despite the fact that the industry generally profitable, the UT Bank and Capital Bank continued to record huge losses that emanated from high non-performing loans which led to high provisioning for bad debt, high operating

cost as a result of energy supply short fall. In addition, very high executive compensation schemes operated by the affected banks contributed to the higher cost to income ratios, which were not commensurate with their operations, risks and earnings (Addison, 2017). For instance, one of the affected bank paid royalties for brand name at the time when that bank's financial performance was abysmal and could not pay dividend to their shareholders and this compounded their poor financial performance (Addision, 2017). This risk and earnings profile of these affected banks could not the high executive compensation schemes. The earnings performance of both UT Bank and Capital Bank were rated by the Bank of Ghana's examinations as critical.

The other financial key ratios adopted by Bank of Ghana to measure cost efficiency are the Cost to Income ratio and Net interest margin (interest spread). Since the deregulation of the financial sector in 1980s, the banking sector has been characterized by high operational costs and wide interest margins. The banking sector has recorded cost to income ratio of 62% in 2008; 57.3% in 2009; 51.8% in 2010; 60% in 2011; 59.8% in 2012; 53.8% in 2013; 49.2% in 2014; 53.2% in 2015 and 57.4% in 2016 (Various IMF reports 2008-2016; Bank of Ghana's various reports 2008-2016). The high cost to income ratios recorded in the banking sector for the period under discussion

could be attributed to higher staff related expenses which accounted for about 50%- 55% and administrative costs which also accounted for 25%-30% in 2011. The high staff related expenses and administrative costs were partly attributable to the rapid expansion of banks' branch network as banks competed for space. According to IMF country assessment report (2011; 11/131), opine that the average overhead cost of the Ghanaian banking sector was 7.6% of the total banking assets which exceeds the Sub-Sahara Africa average of 5.7% (Mayo et al, 2013). The cost to income ratios for the period 2012 -2016 could also be attributed high interest costs, high non-performing loans which led high provisioning for bad debts and high operating costs as result of the energy supply short fall (Bank of Ghana's annual report, 2016). The banking sector inefficiency has manifested itself in the persistent high interest margin which has been attributed to high levels of bank concentration and cost inefficiency (Bawumia, Belyene and Ofori, 2005). The high operating costs contributed to the dismal performance of both UT Bank and Capital Bank. For instance, non-executive directors were rewarded with business class tickets and other perks annually when the affected bank was recording huge losses. Poor cost controls also contributed the collapsed of UT Bank and Capital Bank in 2017. The UT Bank and Capital Bank expense to income ratio of 267.8% and 248.6% respectively

were well above the national average of 57.4 %. These two affected banks refused to take steps to enhance the banks' earnings through the improvement of their loan portfolios and reduced operating expenses. The failure of UT Bank and Capital Bank to sustain earnings suggest that there existed a positive relationship between theoretical literature and bank failure.

Fifth, the Ghanaian banking industry is concentrated (FINSSP,11, 2012). However, the degree of concentration has been declining over the years. The proportion of the total banking assets owned by the six banks declined from 85.3% in 2000 to 69.1% in 2005, to 56.5% in 2009, to 49.9% in 2010, and 43.6% in 2012 (FINSSP 11, 2012). Based on the high percentage of assets owned by the six largest banks, it has been suggested that the Ghanaian banking industry is still oligopolistic (Buchs and Mathisen, 2005), implying the ability of banks in the country to high interest rates. The interest rate spread as a percentage between average savings and lending rates recorded over the period 2008 -2016 ranges between 18.5% and 25.8%. This wide spread between savings and lending rates has hampered Ghana's for faster economic development and also affected financial distresses in the banking sector over the period under review. A study by Chand (2002) shows that when there is high intermediation cost as reflected in high interest rate spread, the borrower may be unable to repay his or her loan owing to the

cost of such borrowing. This leads a high risk of default, hence non-performance which leads to financial distress and ultimately to bank failure.

Sixth, the Bank of Ghana has two liquidity ratios to show how Ghanaian banks are prepared to meet their current and future liquidity needs. Bank of Ghana uses the core liquid assets to the short- term liabilities and broad liquid assets to short term liabilities ratios. The banking sector recorded core liquid assets to the short- term liabilities ratio of 35.5% in 2008; 34.5% in 2009; 32.9% in 2010;35.3% in 2011; 30.76% in 2012; 28.20%in 2013; 34.2% in 2014; 33.8%in 2015 and 33% in 2016 (IMF, 2008-2016 and Various Bank of Ghana reports,2008-2016). Also, the banking sector recorded broad liquid assets to short term liabilities ratio of 52.4% in 2008; 62.0% in 2009; 66.6% in 2010; 67.6% in 2011; 64.8% in 2012; 66.5% in 2013; 62.6% in 2014: 63,6% in 2015 and 61.2% in 2016 (various Bank of Ghana reports 2008-2016). These figures indicate that Ghanaian banks had adequate cash and near cash needed to meet changes in banks' monetary obligations as well as to supply financial resources for their operations and development. The Bank of Ghana's review showed that the Ghanaian banks have averagely strong liquidity levels and fairly developed funds as the banks had access to sufficient source of funds to meet the present and anticipated liquidity needs. The Bank of Ghana, Notice no. BG/ GOV/SEC/2009/5 on the

operationalization of the Banking Act 2004 Act 673 as amended Banking Amendment Act 2007 Act 738 requires that banks to maintain at all times a ratio of liquid assets to deposits of 8%. The UT Bank and Capital Bank did not comply with the above requirements over a reasonable period resulting in the dissolution of the affected banks in 2017. However, on liquidity level, Bank of Ghana's examination found that UT Bank and Capital Bank had critical liquidity deficient over considerable period, for which Bank of Ghana found that these two banks had no chance of seeking immediate external assistance to meet their liquidity requirements, hence the regulator has no option but to close down these distressed banks in 2017. High non-performing loans created liquidity challenge for the two affected banks. This affected their ability to meet obligations when they fall due. This also had negative consequences, such as undermined customer's confidence and trust, panic withdrawals among others. The failure of UT Bank and Capital Bank is consistent with theoretical prediction.

Seventh, the banking sector's sensitivity to market risk refers to the risk that changes in the market conditions could adversely affect the banks' earnings and capital. This encompasses exposures associated with the changes in interest rates which are the primary market risk for the Ghanaian banks. The banks had a positive gap over the period under consideration, with the lowest

point of 39,4% in 2009 while the highest point of 51.4% in 2014 (IMF, 2011, 1MF, 2014, Bank of Ghana's Monetary Policy Committee, 2014). For instance, in 2014, the banking industry had more of its assets pricing (51.4%) than its short-term liabilities re-pricing at (48.6%) thus making a marginal positive on the interest margin in the banking sector. However, UT Bank and Capital Bank had more of their assets re-pricing stagnated while its short-term liabilities re-pricing increased significantly thus resulting negative impact on the interest margins of these two banks. The failure of UT Bank and Capital Bank suggests a positive relationship illiquid assets and bank failure is in conformity with the literature.

Lastly, Bank of Ghana's systems and control reviewed covered portfolio management, internal audit and internal control, accounting, management information system and house- keeping. Most of the banks have adequate portfolio management in place and adequate internal control and audit systems. However, Bank of Ghana noted the quality of most banks' credit portfolios had deteriorated during the period under review. Non-performing loans amounted to 17.3 % of the total loan portfolio of GHc 31.93 billion. Most of the Ghanaian banks observed the independence of the internal auditors which had improved the effectiveness of the internal audit function. Internal audit was found to be independent of the activities and processes

which appraised to ensure that it performed its duties in an objective manner and also provided impartial advice to boards and senior management. The Bank of Ghana's examination of information technology security management practices of some banks found that there were adequate control measures to secure the banks' information technology systems. In some instances, some banks did not have information security policies and approved business continuity and disaster plans.

However, there were weaknesses in the systems and controls of both UT Bank and Capital Banks. The internal control systems and risk management practices were found to be unsatisfactory while there were some lapses in the credit administration prucedures. UT Bank and Capital Bank internal control systems and risk management practices had not kept pace with the industry's growth and changing risks and the failed banks were also highly exposed to credit risks, since lending accounts for bulk of risk assets and they grew in a weak credit risk management practices and enforcement of creditor rights. The failure of these banks was also attributed the dominant role of shareholders who exerted undue influence on management of the banks thus leading to poor lending practices which had resulted in huge bad debt provisioning. Some operational lapses were found in most of the branches as well as land administration procedures. The Bank of Ghana's

examination noted also some deficiencies in the affected banks' information technology systems such that some critical functions were not performed. The systems and controls were found to be unsatisfactory. The failure of UT Bank and Capital Bank to improve on systems and controls suggest that there existed a positive relationship between theoretical literature and bank failure.

In conclusion, the Ghanaian banking industry remained sound, liquid and solvent as at December 2016, despite some marginal declines recorded in the key financial soundness indicators. The key risks to the banking sector as at December 2016, included the high non-performing loans, high operating expenses, and significant exposure to the energy and road sectors. The performance of banking sector is expected to improve on the payment of energy sector bonds by the Ministry of Finance and Economic Planning to the banks. However, the Bank of Ghana's parameters relating to the UT Bank and Capital Bank operations were considered as lowest prudential rating, indicating critically deficient levels of capitalization, liquidity, solvency and performance which raised the highest degree of supervisory concern for Bank of Ghana before the dissolution in 2017.

4i) Other myriad of micro and macro -economic factors that have contributed to financial distresses and bank failures in Ghana.

In addition to the Bank of Ghana's solvency, liquidity, earnings, management, systems and control rating over the period under consideration, there were other myriad of micro economic factors that have contributed to the financial distress and bank failures of both UT Bank and Capital Bank. The micro economic factors can be further be divided between (i) what is internal to the bank and (ii) what is external to the bank which include regulatory factors and the banking environment.

Abusive ownership, weak and ineffective board, poor internal control systems and weak risk management practices, weak regulation and supervision including regulatory forbearances, poor enforcement and inadequate supervision in the Ghanaian banking industry.

a) Abusive ownership and weak board of directors in the Ghanaian banking system, the extent of abusive tendencies varies with the nature of the ownership of distressed banks and they include the following:

i) The government-owned banks suffered frequent changes in board membership usually associated with changes in the Governments for every four years. Many appointments were based on political patronage rather than merit. Board members saw themselves as representatives of political parties, and government and had little or no loyalty to the banks they served. As a

result, political and social considerations pervaded the decision-making processes. This situation promoted indiscipline in such banks as decisions are influenced by extraneous considerations. ii) On the other hand, the privately-domestic banks were afflicted by undue interference and pervasive influence of the dominant shareholder(s). Such shareholders were unable to recruit and or retain competent management teams. The problem of appointing incompetent management is aptly described by Atuahene (2016) quote “Since the owner-managers regard banking as an extension of their business empires, they invariably try to dominate their operations by appointing their relatives or friends to key positions instead of relying solely on professional managers. In some banks, major shareholders appointed their children or friends to key positions without due regard to their level of experience and competence. Ineffective board practices have contributed to the financial distresses and failures over the period 2008-2016 among the state own banks and domestic private banks. Most of the board members did not bring independence and objectivity to bear upon board decision-making. They also lacked the experience, skills and expertise to understand the technical issues in the banking business.

Most board members are appointed on the basis of political, family or social and religious connections to the banks’ boards without regards to

competencies, experiences, skills, expertise and the relevant qualifications as set out in the Core Principle 3 of BIS (2006). Failure on the part of Bank of Ghana to strictly apply the proper and fit test under the Core principle 3 of BIS (2006) might have contributed to distresses and bank failures. The question that arises who did approve a "Man of God" without the proper experiences, skills and competencies to chair the board of failed bank without compliance to the Core principle 3 of BIS (2006) and Section 44 (sub-section 4) of the Banks and Specialized Deposit Taking Institution Act 2016 Act 930. This was a clear case of regulatory failure on the part of Bank of Ghana. Regulatory Authorities have not declined approval of such board and managerial appointments, where these people are known to have caused financial malpractices such as insider lending, related or connected lending and tunnelling in their previous appointments. Glorifying mediocrity in the banking sector is normal phenomenon in the Ghanaian banking system.

iii) Some of the domestic private banks were characterised by undue influence and pervasive influence of dominant or majority shareholders which contributed to financial distresses and bank failures in Ghana. Some shareholders were mere strange bed-fellows who came together to meet the regulatory requirement of the spread for ownership of banks and the ceiling on individual shareholding. There was also the problem associated with the

raising of initial capital of some of the banks which as a result of the crisis, it was discovered that the share capital was contributed by a few “well – to – do” individuals. As soon as the banks commenced operations, the minority or nominee shareholders felt marginalised. In some cases, it was discovered that the major promoters raised commercial papers for statutory paid-up capital and used depositors’ funds to liquidate such facilities. iv) The consequences of the crises included irregular board meetings; lack of management cohesion as members and officers represented different and opposing interest group; confusion and chaos in the bank; high labour turnover; and loss of public confidence, all of which adversely affected the banks. Addision (2017) cited that the dominant shareholders in UT Bank and Capital Bank exerted undue influence on the management that led to poor lending practices that resulted in huge non-performing loans which led to the dissolution of the two banks.

v) Most of the bank directors were ill-informed about the banks they oversighted. Even where some of them were willing and interested in the affairs of their banks, they were not provided with useful and relevant information by the management. Addison (2017) cited some examples of recklessness on the part of the boards which led to the failure of UT Bank and Capital Bank include-; (i) comingling of banks’ activities with their related

holding companies (business conglomerates). For instance, one bank paid royalties for the brand name, even when the bank's financial performance was so poor and abysmal, when the affected bank could not comply with primary reserve requirement, liquidity ratio requirement and minimum capital adequacy ratio. On the royalty payment, four (4) "yes-men or passive" non-executive directors out of the seven (7) board members approved this transaction without the full knowledge of the three non-executive directors and significant minority shareholders (Addision,2017). As part of their "tunnelling" practices at these banks, they were high executive compensation and perks schemes operated by these failed banks which were not commensurate with their operations. This risk and earning profile of these banks could not support the executive compensation schemes.

c) Corporate governance provides structure and processes within which shareholders, directors and senior management conduct the business of a bank with ultimate objective of realising long-term shareholders' value while taking into account the interest of other stakeholders such as depositors, customers, regulators and supervisors and the governments. Good corporate governance demand not only transparency, accountability and probity but also a sense of conviction and commitment to ensure that the interests of all parties are protected. Weak corporate governance has played

a major role in financial distress and bank failures in Ghana over the past decade. Weak corporate governance practices, particularly connected lending and contravention of supervisory provisions, overbearing directors' interests in loans and advances or any credit facilities are some causes of bank distresses and failures (Kama, 2009). The failure of UT Bank and Capital Bank suggests a positive relationship between weak corporate governance practices and bank failure is compatible with the literature. The universal banking model in 2003 with its attendant recapitalization in 2003; 2008; and 2013 brought huge surge of capital during the periods when corporate governance standards were extremely weak. In fact, failure in corporate governance practice at banks was indeed a principal factor contributed to the financial distresses and bank failures. The deregulation of the Ghanaian financial sector in the early 1990s and 2000s failed to address the fundamental weaknesses in corporate governance practices in most of the state own banks and domestic private banks, as some engaged in unethical business such as insider lending, related or connected lending and over excessive risk taking. Governance malpractices at some banks remained uncheck at deregulation, became way of life in large parts of the banking sector, as few directors and executive management enriched themselves at the expense of many depositors and investors.

Corporate governance in domestic private and state- own banks failed because boards ignored these practices for reasons including being misled by executive management, participating themselves in obtaining unsecured loans and advances at the expense of depositors and not having qualification to enforce good corporate governance on bank management. In addition, the internal control systems, audit committees and risk management committees of these banks appeared not to have taken fully into account of deterioration of the banks' risk assets and failed to make adequate loan loss provisions against risk assets. As the banks grew in numbers after deregulation in the 2000s (from 16 in 2006 to 33 in 2016), banks' boards often did not fulfil their function and were also lulled into a sense of well- being by the apparent year over year growth and profitability. In hindsight, boards and senior management of some the domestic private banks engaged in building business empires through financial conglomerates (insurance companies, savings and loan companies, supply and logistic firms, stock brokerage firms and investment fund firms). For the domestic private banks, the board chairpersons and CEOs often had overbearing influence on the boards, and some boards lacked independence and objectivity and as a result, directors often failed to make meaningful contribution to safeguard the growth,

sustainability and development of the banks, and had weak ethical standards; the board committees were also often ineffective or dormant.

Addison (2017) cited that that the failure of UT Bank and Capital Bank were due to significant capital deficiencies with the underlying reason being poor corporate governance practices within these two banks. In some instances, dominant or majority shareholder exerted undue influence on the management of the banks, causing poor credit practices and weak credit administration procedures. This was also reinforced by weak risk management practices and poor oversight responsibility by the “passive” board of directors. UT Bank and Capital Bank were set up with less ethical motives in mind, because of the extent of insider lending and connected lending had been considerable suggesting that the affected banks were set up to enable owners to divest funds for their other business ventures. UT Bank and Capital Bank had poor lending practices such as poor underwriting skills or overly aggressive loan expansion programme, coupled with absence of incentives to identify problem loans at an early stage and to take corrective action

Weak corporate governance and/or mismanagement played a major role in bank failure in Ghana. Other factors which contributed to mismanagement included the following. (i) inexperienced and incompetent personnel were

recruited to hold key positions in banks. As a result, most of them lacked the ability to respond to the rapidly changing economic conditions and regulatory framework. ii) Significant deterioration in management culture, as the distressed condition of the banks got worse, manifested in most banks. Deterioration involved several stages. Initially, it involved inadequate policies, procedures and practices which resulted in over extension of credit, disregard of single obligor limits and poor lending procedures. As the losses increased, the management of UT Bank and Capital Bank tried to hide losses so as to buy time and remain in control. This led to manipulation of profits; under provisioning for losses through ever greening procedures or revaluation of fixed assets. Diversion of funds to holding companies and other subsidiaries were wide spread (Addison, 2017). There were some governance failures in both UT Bank and Capital Bank. Some instances of weaknesses in carrying out the responsibilities of governance were found. The records indicated that some members of the board of directors showed lax attitude towards governance. Some members appointed to board did not have requisite experience, skills and not enough motivation for their job. While some board members had conflict of interest owing to their dual role as board members as well as external consultants.

When the banks became severely insolvent, management resorted to desperate strategies to boost liquidity or income levels. The practices included abuse of the clearing system through the issuance of phantom up-country cheques, purchasing high cost funds at rates above the market levels, lending to marginal or fringe borrowers at excessive rates or engaging in speculative transactions. Furthermore, where the UT bank and Capital Bank became insolvent and illiquid, the management engaged in massive excessive risk -taking practices. These included outright theft and diversion of banks assets to related companies or fictitious companies. For example, local buying cocoa purchase scam costing 23 banks more than US$ 200 million. The culture of phantom business was elevated to corporate level and permeated all layers in the organisations. Non- adherence to credit management procedures and practices as the UT Bank and Capital Bank were heavily exposed to insider lending and connected lending.

(d) Ineffective board of directors has also contributed to the distress and bank failure in the banking system. According to Addison (2017), some non-executive directors of the UT Bank and Capital Bank compromised their independence and objectivity and fiduciary duties to check on the executive directors. For instance, interference by non-executive directors in the day to day operations of the banks weakened the management oversight function

of executive directors. In some cases. Non-executive directors were also acted as consultants to some banks with no clear mandate, which gave rise to conflict of interest.

(e) Risk management deficiencies were contributing factors for wide distresses and failure in the banking sector. Bank of Ghana supervisors did not evaluate a risk management approach to supervision of banks over the period. The existing approach did not focus on the adequacy of internal risk management controls at banks and relied increasingly on banking institutions to supervise their own activities, even though on site examiners were on the premises of the two failed banks at all times. The Bank of Ghana's examiners did not also issue a steady stream of supervisory guidelines on risk management issues, but allowed the individual bank the flexibility in devising their own internal risk management control and compliance systems. There were significant risk management deficiencies at the both financial distressed and failed banks, but the examiners did not evaluate potential risks, particularly in the case of solvency – threatening, worst case scenario.

(e) Difficulties in the implementing of enterprise wide and consolidated supervision by the Bank of Ghana was one of regulatory weakness that might have contributed the financial distresses and bank failures. The complexity

of banking organization especially with universal banking concept made it difficult for Bank of Ghana's examiners to fully assess risks within such organisation on an enterprise wide basis. UT bank ltd typically had many subsidiaries (insurance, real estate development and logistics & supply) and the interaction of risk among them was not always fully appreciated, making overall systemic risk over sight difficult. Bank of Ghana inability to conduct consolidated supervision on UTs business group activities might have contributed to the failure of the bank.

(f) Supervisory effectiveness continues to be impaired by forbearance and distraction from prudential objectives. While the Bank of Ghana has planned to restrict new waivers from the single obligor limits to exposures to SOEs in relation to oil and gas business, banks continue to have expectations that waivers will be granted at short notice where energy supplies are concerned. In other areas, effective supervision might be compromised by elevation over prudential considerations of wider objective such supporting growth in banking lending and these actions might have contributed the wide spread financial distresses in the banking sector (IMF,2013/ 13/187; IMF 2011). The regulator allowed both UT Bank and Capital Bank to operate well over three years even though they were found be insolvent and illiquid. The delayed in closing down UT Bank and Capital Bank had cost the government nearly

GHc 3.4 billion (Adongo, 2017). According to Adongo (2017), GHc 1.4 billion was used as liquidity support for the two failed banks in 2016 prior to their collapse in August 2017, while GHc 2billion was to be used to pay for difference in the valuation of selected assets and liabilities were taken over.

. (g) Bank of Ghana continues to lack a comprehensive crisis management plan and full bank resolution powers. Until 2017 where UT bank and Capital Bank failed, there were no bank failure since 1999 when the BHC and Ghana Cooperative Bank failed. The Bank of Ghana used to manage stress at banks by relying on extensive informal intervention powers, liquidity support and various forms of forbearance which might have contributed the distresses over the period 2008-2016. With the passage of the Banks and Specialised Deposit Taking Institution Act 2016 Act 930 the options provided for resolution in legal framework are very comprehensive. In addition, the Deposit Protection Act 2016 Act 931 with deposit insurance scheme to support the Bank of Ghana's resolution powers.

(h) Bank of Ghana's difficulty in assessing the banks' new risks might have contributed to the wide spread distress in the banking system. Banking regulator in some cases relied solely on the bank's own assessment of risks rather than arriving at an independent risk assessment, particularly in the case of oil and gas business. Among the examples cited were in respect to

the energy and road sectors, where the underlying assumptions relied on the lack of historical losses and the diversification of product issuers (ii) a failure to understand the size of risk was not necessarily correlated to size on the balance sheet, (iii) failure to challenge management's model testing and validation.

i) Weak internal control systems characterised the operations of many distressed banks. Even where the controls were in place, they were not being complied with. Internal Audit or Inspection functions were found to be weak and sanctions were not imposed on erring officers. The consequences of weak internal controls were clearly reflected in the volume of insider lending, connected lending and excessive risk taking and poor credit administration procedures.

j) Non-compliance with laws and prudential standards. Management of UT Bank and UT Banks did not have prescribed code of conduct and also failed to keep proper books and accounts in contravention of applicable banking laws, rules and regulations. Non-compliance with the Bank of Ghana's Capital Adequacy ratio of 10% of Section 23 (1) of the Banking Act 2004 Act 673 and the Primary Reserve Requirement of 8% under the Bank of Ghana's notice no BG/GOV/SEC/2009/5 were some of the lapses. Failure to comply with Section 42 (1) of the Banking Act 2004 Act 673 which stipulates that no

financial institution shall expose itself to one person or group of persons which constitute in the aggregate more than 25% of its net own funds where the facility is secured. Bank of Ghana's examinations revealed that UT Bank and Capital Bank were over- exposed to some of their loan customers as a result of its negative net-worth.

k) Weak Risk Assets Management Practices have contributed the financial distress and failures in the Ghanaian banking system. A number of banks had poor credit policies and in cases where good policies were in place, they were not faithfully implemented. Loans were granted without due regard to ability of borrowers to repay. Several loans were granted without collateral and even where secured, the collaterals were found to be inadequate or non-existent. For instance, one of the failed banks imported refined petroleum product worth of US $ 14 million without adequate security over the facility. Instead of using the imported petroleum product as a collateral through the use of tank farms by SGS and Vitol, the bank rather handed over the refined petroleum product to their customer without any security. The customer sold the petroleum product without paying the US $ 14 million debt. credit administration was also found to be weak as credits were not being properly secured and monitored. As can be seen from above, the proportion of non-performing loans in the distressed banks had during the period 2008 – 2016,

been consistently high, reaching about 80 per cent of their loan portfolio. This ratio significantly exceeded the prudential maximum ratio of 20 per cent. Lending to governments and their SOEs (VRA, Gridco, Ghana Electricity Company, TOR) also contributed to the distressed conditions of many banks. In most of the banks that failed little attention was paid to sound assets and liability management. Loans were granted without regard to the tenor and nature of the funding base of the banks. positions of many banks and cross-defaults in the inter-bank market. Some of the banks had no funding or placements policies which would have placed limits and discriminate against unsound banks. This weakness resulted in massive cross-defaults in the inter-bank markets

k) The banking industry witnessed a steady and large- scale deterioration in capital positions until 2017 when the UT bank and Capital bank were closed by the Bank of Ghana. The minimum capital requirements for banks were increased from GHC 7 million in 2003 to GHC 60 million in 2008 and later to GHC 130 million in 2013. Despite the measures taken by the Bank of Ghana on the increases of minimum capital requirements to ensure capital adequacy for the Ghanaian banking system, capital inadequacy continues to be a prime factor causing financial distress and bank failures. This is because minimum capital requirements have been eroded by high inflation,

persistent currency depreciation and huge non-performing loans which eroded the shareholders' funds. In fact, the present Bank of Ghana's minimum capital requirement has been seen by many people especially domestic private investors as rather compounding rather than alleviate the problem. Many of the private domestic banks are grounded in a scramble to meet up with the new recapitalization. UT Bank and Capital Bank were deeply insolvent, meaning that their liabilities exceeded their assets, thereby putting them in a position not to be able to meet their obligation as and when they fall due. Poor capital management planning, undefined business models and poor business strategies might have contributed to the negative capital adequacy ratios of the UT Bank and Capital Bank.

Despite repeated agreements between the Bank of Ghana and UT Bank and Capital Bank to implement an action plan to address these significant shortfalls in capital and liquidity requirements, the owners, board of directors and managers of the two distressed banks, but they were unable to increase of the capital of banks to address the insolvency and Bank of Ghana had no option but to revoke banking licenses of UT bank and Capital Bank under the Purchase and Assumption transaction. The capital deficiency is a result of many factors. First, some of the banks were established with inadequate capital and failed to increase their capital base to meet the growth in their

risk assets portfolios. Increased provisions for loan losses as a result of increasing level of non-performing loans further eroded the capital funds of many banks. Second, some shareholders whose banks were insolvent refused or were unable to recapitalise them. They also made unrealistic offers to new investors who sought to acquire and recapitalise them.

There is no doubt that the banking industry remains the nerve centre of the economy being the supplier of credit which facilitates economic growth. Since the early 2008, a number of factors, national and international, had induced greater instability in the economic environment for the Ghanaian banking industry. While prudently managed banks are expected to plan to cope with normal and reasonable degree of volatility, many banks found it difficult to survive under greater and sometimes unusual macroeconomic volatility. Some of the changes and their impact on the banking industry are summarised as follows:

I) While the deregulation of interest rates resulted in substantial increase in lending rates, the liberalisation of the exchange rates led to substantial depreciation of the Cedis against major trading currencies. The combined effects of these changes impacted adversely on the ability of borrowers to service their debts which increased the rate of defaults. Also, with large exchange rate premium between the official and parallel markets, many

banks arbitraged between the two markets, the benefits of which in many cases accrued to owners and managers of the banks. In fact, it is a widely held view that phenomenal growth in the number of banks was as a result of rent seeking tendencies of promoters of bank. The wide spread between savings and lending rates has hampered Ghana's aspirations for faster economic development and has also contributed high default rate. Reforms in Ghana's financial sector have not led to any significant improvement in banking efficiency as reflected in the high interest rate spread.

m) The attitude of some Ghanaian borrowers further accentuated the poor financial condition of some banks. Some of these borrowers would wilfully default in servicing their credit even when they are known to have the means to do so. Another category of borrowers regards such credit as their share of the national cake which was not meant to be paid back.

n) Weaknesses of the regulation and supervision of financial system is viewed as major factor, contributing to the emergence of bank distress and financial crisis (Mishkin, 2001; Fischer and Risen, 1992). It is argued that if financial liberalization is accompanied with weak prudential supervision of the banking sector, then it would result in excessive risk taking by financial intermediaries and subsequent crisis (Dermigue – Kunt and Detriachge ,1998; Edwards, 2000). Weaknesses in enforcing prudential regulations

allowed some banks to build up substantial loan concentrations without due regards to the regulatory limits under banking law. Bank of Ghana's forbearance policy enabled banks to build loans concentration above regulatory limits and also failed to maintain loan loss provisions especially in the energy sector (IMF,2011;2012; 2014; 2016), while deficiencies in prudential data collection and analysis of individual bank risk and systemic risks had also led to an under –appreciation of the stability risk implications. Furthermore, political pressure is brought to bear on central banks to exercise regulatory forbearance especially in the cases of the state- own bank and private domestic banks. Forbearance remains a feature of the Bank of Ghana's supervision, evidenced by its approach to weak banks and readiness to grant waivers from large exposures (single obligor) limits (IMF,2013). The Bank of Ghana lacked sufficient political independence from government to refuse liquidity support to politically connected banks or state-own banks and to strictly enforce the banking laws and regulation. Supervisory effectiveness continues to be impaired by forbearance and distraction from prudential objectives. According to IMF country assessment report (2013/ 13/187), Bank of Ghana over the period restricted new waiver from single obligor limits to exposures to SOEs in the oil and gas businesses,

some banks continued to have expectations that new waivers would be granted at short notice where energy sector is at stake.

n) The Bank of Ghana's uneven supervision and inadequate enforcement had also played significant role in exacerbating the problems associated with both financial distress and bank failures over the past decade. Regulator was ineffective in oversight and supervision of the massive changes especially with introduction of universal banking model in the banking industry or in eliminating the pervasive corporate governance failures. There were many instances of weaknesses in the supervision and enforcement process. For example, Bank of Ghana's examinations were not conducted on a bank consolidated basis. In addition, Bank of Ghana did not provide input to other regulators such as Securities and Exchange Commission in planning its examinations of UT Bank operations. Also, the rating and depth analysis weren't sufficient to capture the distress and insolvency issues of both UT Bank and Capital Bank. For example, Bank of Ghana's SLEMSC ratings did not differentiate the performance of successful and failed banks. While Bank of Ghana's examination identified critical risk management issues, many issues the caused the distresses in the industry and ultimate collapsed of UT Bank and Capital Bank escaped the examinations even though they were well known in the industry. Enforcement was the biggest failure

among surveillance processes, despite that Bank of Ghana had all powers under the banking laws to enforce examination recommendations. Bank of Ghana's sanctions and financial penalties were woefully inadequate to enforce compliance. By paying token penalty points and meagre fines, the UT bank and Capital Bank effectively annulled key aspects of Bank of Ghana's examination reports over the period under review. Also, with examination cycles between 9 months and 18 months, follow up on examination recommendations were rolled up into the following year's examination. The prevailing view that the banking sector was health and sound (IMF, 2012;2013;2014;2015), a culture of tolerance and acceptance of the status quo and shortage of specialist skills in universal banking concept compromised supervision effectiveness (Sanusi, 2010).

There was insufficient discipline in holding the UT Bank and Capital bank boards of directors to clear remedial program. While these two banks responded to the Bank of Ghana's examination reports, the boards and senior management seldom committed to specific deliverables, timing or executive responsibility for implementation. Hence, it was difficult for Bank of Ghana to measure the two banks progress against compliance with some of the major recommendations such as recapitalization and the reduction strategies for high non-performing assets. The compliance of these affected

banks was very poor, as owners, boards and senior management frequently ignored the Bank of Ghana’s recommendations despite of seriousness of the issues. The consequence to the two banks of non-compliance was not sufficient to change the behavior and attitude of boards and management. The boards and senior management faced no personal liabilities as done in other jurisdictions for non -compliance. The Bank of Ghana allowed this poor practices and behavior to go unchecked for the period under review, establishing a way of doing business that compromised the Bank of Ghana’s supervision process. The failure of UT Bank and Capital Bank suggests that there is direct relationship between uneven supervision and inadequate enforcement and bank failure which is in conformity with theoretical literature.

(o) Even though Banking Act 2004Act 673 as amended Banking Amendment Act 2007 Act 738 and Banks and Specialized Deposit Taking Institution Act 2016 Act 930 and other banking regulations have been revised to provide greater autonomy and powers to the central bank to supervise the banking system and take timely action with respect to troubled banks or suspended their activities indicating regulatory forbearance. Bank of Ghana has not implemented exit policies, transfer of assets and liabilities, and the removal of the boards and senior managers who are ‘not’ fit and proper and imposed

serious sanctions and penalties on the individuals who caused the failure and distresses of banks in Ghana IMF, 2011). The Bank of Ghana should establish the questions and forms used in conducting security checks for proposed owners of banks, proposed directors of banks and proposed senior management of banks and other financial institutions, in line with "best international practices" for example individual who caused the demised of two state own banks was granted license to run savings and loans company with impunity. This can only happen in Ghana. Who issued the license to such an individual? What due diligence was done on such individual? Principle 3 of the Core Principle of BCBS cited that licensing authority should evaluate proposed board members and senior managers for fitness and propriety. Regulatory failure on the part of Bank of Ghana for not applying the Basel Core Principle 24 on consolidated supervision and financial conglomerates since the adoption of the universal banking model in 2003 might have contributed to the failure of UT Bank in 2017. Bank of Ghana's inability to supervise the UT group on a consolidated basis, inadequate monitoring and not applying prudential norms to all aspects of the business conducted on group wide might have caused the failure of UT Bank

p) Poor bank capital management practices had been one of the challenges facing the banking system. Some of the observed weaknesses reflected in

the banks' management and processes were not sufficiently comprehensive and not adequately formalized. As a result, some senior management of UT Bank and Capital Bank under-estimated the risk inherent in the banks' business strategies and in turn, misjudged capital needs. In absence of comprehensive capital management policy, the affected banks continued to pay royalties for brand name, when capital could be retained to insulate themselves against potential future losses. One of the failed banks also issued large amounts of capital instruments –such as "hybrid debt" that ultimately proved ill equipped to absorb realized losses. UT Bank and Capital Bank capital, risks and business models were not deeply connected to their business models. The UT Bank and Capital Bank capital management were not inherently linked to risk, business model and banks' risk appetite did not influence it strategic choices. Capital management is the way that risk management finds expression in bank strategy at the highest level. Bank capital should be absolutely linked with bank strategy. However, UT Bank and Capital Banks' capital management were not properly linked to their business models and strategies. The failed banks' capital management processes, banks did not define their strategy or where these banks wanted to grow? What were the banks risk appetite? This definition of the bank's risk appetite will depend on many factors: its competitive landscape; its existing

competencies; its foot print and growth aspirations and (iv) do the banks want to market share. All these factors go into the bank capital management equation. In summary, most banks did not scale their decisions about the level and composition of both economic and regulatory capital to the potential impact of changing economic conditions in Ghana.

Banks with stronger governance of the capital management and planning process require the board of directors or committees therefore to consider the capital management process when appraising business developments and strategy. Capital management policy is a written document agreed by the board and senior management of the bank. It specifies the principles that senior management will follow in making decisions about how to deploy banks capital management policies should also incorporate minimum thresholds that's are monitored by management to ensure that bank remain strong. An important statement to the capital management policy is the expression of risk tolerance by senior management and board of directors. A risk tolerance statement is approved by the board and renewed annually. This directly informs the banks business strategy and capital management, including, for example, through the establishment of return targets risk limits and incentive compensation frameworks at the group and business level (BCBS,2014). The board of director set the risk appetite level which

cascades through the organization through limits and controls. Risk measurement will have to be undertaken by the respective functions such as treasury, finance, credit, risk and operations and report directly to decision makers such as senior management, risk committee of the board and the board at large.

Another key element of a sound capital management and planning is stress testing or scenarios analysis. As noted in the “principles for sound stress testing practices and supervision” issued by Basel committee in May, 2009 an effective capital management and planning requires a bank to assess the risks to which it is exposed and to consider the impact on earnings and capital from and assumed economic downturn. In the other words, stress testing should be integral component of banks capital management and planning process. Indeed, stress testing and scenario analysis provide a view as to how the bank’s capitalization could be jeopardized if there were dramatic bank-specific or economic change (BCBS, 2014).

UT Bank and Capital Bank did not use stress testing and scenario analysis in their capital management process and planning. The stress testing and scenario analysis were absent in the affected banks especially with energy sector debts, which made banks capital highly vulnerable. Again, the affected banks did not have capital management policy which expressed the

link between business strategy, risk appetite and risk tolerance. The use of stress testing and scenario analysis to identify and respond to vulnerabilities remained underdeveloped in Ghana (IMF, 2013, 13/ 187).

p) The various financial sector policy reforms introduced by the government and the Bank of Ghana in rapid succession and the technological changes appeared to have put the regulatory and supervisory framework under severe stress. The regulatory framework was unable to keep pace with the rapid changes in the banking industry. Supervisory resources were overstretched especially as a result of phenomenal growth in the number of banks and non-bank financial institutions after the deregulating of the financial sector in the early 1990s and 2000s. There was initial delay in prompt identification of emerging problems in the banks as a result of many factors which include:

q) Inadequate regulatory capacity in the period under review has been a major challenge for the banking sector. Given the phenomenal growth in the number of banks, the supervisory expertise and the number of supervisors were inadequate. Examination cycle which is the interval between one on-site examination and another was between one and two years as a result of which problems in banks were not being detected on time.

r) Another problem related to supervisory capacity is the inadequate skills especially in information Technology. With improved IT capacity, some banks were able to window - dress their records thereby hiding losses and fraudulent transactions. Bank of Ghana have intensified efforts to make all examiners IT proficient especially in the use of Audit Command Language (ACL) software. Until recently the supervisory focus of Bank of Ghana place greater emphasis on credit risks. But in keeping with international supervisory standards, risk-based supervision is now being adopted which allows for effective evaluation of safety and soundness of a bank by focussing supervisory resources on the banks major risks. There had been inadequate disclosure of information especially through the audited financial statements until the release of the International Financial Reporting Standards

s) Some of the supervisory and monetary policies introduced though intended to address emerging problems and sanitise the system, had to some extent adversely impacted on the performance of many banks. These include:

The introduction of the International Financial Reporting Standards on assets classification and provisioning for loan losses exposed weak and poorly managed banks. Banks that hitherto posted large paper profits

reported heavy losses resulting in under-capitalisation because of the substantial increase in provisions for loan losses as required by the IFRS. This was in spite of the fact that banks had the option to spread the shortfalls in provisions over a four-year period. The IFRS had assisted in ensuring timely recognition and provision for delinquent credit facilities thereby assuring the reliability of published accounting information and operating results.

iii) Failure resolution measures adopted by the Bank of Ghana, though understandably protracted, delayed early resolution of UT bank and Capital Bank. Distressed UT Bank and Capital Bank were therefore left open for a longer period which further increased losses and the eventual cost of resolution. The stalemate and the lingering problem of distress undermined public confidence in the banking system. Perhaps one needs to examine the environment and constraints the Bank of Ghana faced in addressing the banking crisis in order to appreciate the modest achievement made in this regard. Inability to take prompt corrective actions under the Banking Act 2004 Act 2004 as amended Banking Act 2007 Act 738 affected the powers for resolution. Until end of December 2016 when Banks and Specialised Deposit Taking Institution Act 2016 Act 930 and Bank of Ghana Amendment Act 2016 Act 913 were promulgated, the Bank of Ghana did not have adequate powers

to apply remedial action on distressed or failed bank despites the establishment of commercial courts. Unnecessary delay was experienced in obtained court orders to acquire banks for the purpose of sale. In few cases the erstwhile shareholders employed all sort of delay tactics to frustrate the grant of court orders while at the same time refused to recapitalise them.

t) External Auditors had also come under criticism for not being able to report many irregularities which appeared to have contributed to the distressed conditions of many banks. Bank of Ghana earlier expressed the concern on the performance of bank auditors by acknowledging that: “We must accept part of the blame for the failed banks as auditors for all of them, but also in many cases as part of management, our duties as Auditors should be reviewed and, if necessary, extended to adequately serve the needs of this community at this time. An Audit Report which absolves us from all blame does not give value for the fees charged, the community expects to have full confidence in the accounts and the operations once the Auditor has given a clean report”. In order to strengthen the supervisory framework, the Bank of Ghana recently initiated a number of measures to improve cooperation between Bank Supervisors and Auditors which include inviting auditors to attend Board meetings where examination reports are presented. The Bank of Ghana raised audit standards through auditor rotation and supervisory

meetings with banks and auditors in 2013, but these measures did not improve audit standards of both UT Bank and Capital Bank.

‘5) **Conclusion**

So far, we have discussed the factors that have contributed to financial distress and banking failures including the demise of UT Bank and Capital Bank in 2017. Several lessons that have been drawn from the discussions have been listed below for our experiential learning. We cannot have a failure-free banking system and must accept some inherent instability in the system. However, to fail or refuse to learn lessons from errors or mistakes of the past, is to be doomed to repeat them. Therefore, this article strives to do better in handling future banking crisis. The ultimate responsibility for the health of a bank largely rests with its Shareholders, Board, Management and a robust regulatory and supervisory framework to help in dealing with financial distresses and bank failures. There is no check-list of quick-fix measures for ensuring the soundness of a bank. The most important guarantee is sound management and effective board. If the boards and management are competent and effective, the bank can remain profitable and sound, such that the banking system in particular and the economy in general, will be spared the pains of distress. It is therefore necessary for us to appreciate that banking supervision can also help to prevent bank failures.

Rather, it can also help to reduce the impact of banking crisis. The most important mechanism that can guarantee the soundness of any bank is effective board structure and practices. If the board is effective and competent, the directors will be able monitor and supervise the managerial side of a bank and minimise problems. The management is another that guarantees the soundness of a bank. If the management is competent and effective, the bank can remain profitable, liquid and solvent, such that the banking system in particular and the economy will be spared the pains of distress and failures.

Robust regulatory and supervisory framework will have to be pro- active to identify problems at early stage, adopt preventive or corrective measures and have agreed recovery and resolution strategy in place should preventive action fail. The supervisor's resolution strategy will have to take into account of the bank's systemic significance. According to BCBS (2014) the guiding principles for supervisors or regulators in dealing with distress or weak banks should include (i) early identification of risks and other problems; (ii) early preparation (iii) early intervention (iv) avoiding moral hazard and (v) avoid potential systemic problem. Furthermore, supervisors should provide guidance for banks and supervise corporate governance practices at banks including comprehensive evaluation and regular interaction with boards,

management and external auditors. Supervisors should also establish guidance or rules, consistent with principles set forth in the mandatory code of corporate governance practices, requiring banks to have robust risk management practices and effective board practices.

6 i) **Lessons for government, banks, board of directors and management**

There are number of general and specific lessons obtained from the financial distress and bank failures with particular reference to the dissolution of UT Bank and Capital Bank which are of interest to the Bank of Ghana as a regulator, banks' board of directors, senior management and local institutional investors. Even though we can often understand what happened in retrospect, taking the necessary concrete actions to prevent recurrence is much more challenging. There are a number of lessons to be learnt from the recent past financial distress and bank failures and these include the following:

a) Stability of the banking system depends on strong and stable economy. The government needs to improve macroeconomic stability by strictly limiting government borrowing requirements. On the monetary side, open market operations should shift from the financing of the budget deficit from banking

to non-banking. The government's fiscal policy strategy must be underpinned by debt reduction path aimed at ensuring the availability of enough financial resources into the economy for the private sector to access for increased economic activity. The government must limit its role in the economic activities in order to reduce its persistent arrears to the bulk oil distribution companies, VRA, Electricity Company of Ghana, Gridco, TOR, road contractors and other service providers which have contributed to high non-performing loans over the past decade.

b) As the size and numbers of the Ghanaian financial industry grows its exposure to macro-level shocks also increases, banks should carefully monitor these developments and prepare in advance as much as they can ride over the anticipated developments and problems.

c) The Ministry of Finance and Economic Planning and Bank of Ghana should ensure that every bank has an approved whistle blowing policy that will encourage stakeholders to report unethical conduct and violations of any laws or policies to the Bank of Ghana's Banking Supervision Department, so that such misconduct or violations could be verified, investigated and appropriate sanctions applied to avoid its reoccurrence. The Bank of Ghana should also ensure that the whistle blowing mechanism include a dedicated telephone line "hot line" e-mail address and other electronic communication

methods that could be used (even anonymously) to report illegal or unethical practices in the banking industry.

d) Deregulation programmes must be properly sequenced. Financial liberalization is normally undertaken as part of general programme of reforms embracing stabilization and liberalisation. Timing has to do with where to place financial liberalization within the general frame work of reforms. There is a fair convergence in the belief that stabilization efforts which will include sizable reduction in budget deficits, stability in the exchange rates and reduction in the rate of monetary growth and hence deceleration of inflation should be accompanied before embarking on financial sector reform. To embark on financial liberalization in the face of high inflation which often accompanies stabilization measures is to invite chaos as both deposit and loan rates are likely to increase uncontrollably (McKinnon, 1991). The increase in loan rates is more often than pronounced, impairing the credit worthiness of corporate borrowers and swelling the rank of loan defaulters thus compromising the portfolio of commercial banks and stability of the financial system (Villanueva & Mirakhor, 1990). Sequencing is the framework refer to the chronological order in which individual financial reform policies are implemented (Turtleboom, 1991).

e) The government should establish an independent ombudsman for the Ghanaian financial sector. The role of a financial service ombudsman is to resolve disputes between financial services providers and their clients. The ombudsman is normally established as an independent institution and is expected to perform its functions without fear, favour or prejudice. Countries that have financial ombudsmen include UK, Australia, Mexico and South Africa. Empirical evidence in these countries shows that the financial service ombudsman is able to resolve disputes much more quickly than the existing multiple regulators in Ghana act as the referees and players.

f) Ghanaian banks need to be more compliant with the Section 16 of the Bank and Specialised Deposit Taking Institutions Act 2016 Act 930 on prudential requirements such as capital adequacy ratio, primary and secondary reserve requirements among others. Hence, Ghanaian banks should do their utmost to comply with the requirements spelt out in the Banks and Specialized Deposit Taking Institutions Act 2016 Act 930 as well as other prudential requirements.

g) Bank owners should realise the need to separate ownership from control. They should therefore endeavour to set broad policies install effective board of directors composed of experienced, knowledgeable, resourceful and trustworthy members. Meddlesome interference by majority shareholders

are found to have inhibited professionalism as well as being counter-productive.

i) Ghanaian banks should adopt stricter criteria for appointment of membership on the board of directors, so that those are appointed have sense of responsibility towards improving corporate governance practices in the banks and also are sympathetic to the promotion of good corporate practices in the industry. They should not be “passive” or “yes men” board members but also have in-depth knowledge, skills and competencies and have experience of working in the Ghanaian financial sector. They should also be well informed of the country specifics and international regulatory rules and laws which implications for the bank. In addition, nominated board members must be subjected to proper and fit test by Bank of Ghana under the section (44 Sub -Section 4) of Banks and Specialized Deposit Taking Institution Act 2016 Act 930. Banks especially local banks should also be more vigilant about the changing economic and regulatory environment and they should be careful in their hiring senior staff members ensuring their competencies, experience, skills, trustworthiness as well as reputation as some of the senior management employed lately have in their banking careers caused some malpractices and financial malfeasances. Board of

directors should hire competent professionals with proven track record and experience in the banking business.

h) Every bank should have in place an articulated risk management framework. Both the board and management should be conversant with the array of risks to which their banks are exposed and be satisfied that their banks are adequately identify, measure and manage them. Indeed, concentration risk contributed to the failure of UT Bank and Capital Bank which were liquidated in 2017.

i) Since domestic private banks are individually small, they need to support each other instead of getting involved in cut throat competition. In this regard, creation of an informal association of domestic private banks can play an important role in improving coordination and cooperation among them. Such informal support measures are necessary at least in the teething stage of domestic banking sector until they are able to rub shoulders with the well - established foreign and local banks

j) Banks should adopt a strong credit culture by strengthening their internal controls and risk management practices including improving their credit risk assessment, adoption of stringent acceptance credit criteria, improving on credit administration procedures including the legal perfection of securities,

monitoring and supervision and collection systems as well as debt recovery procedures to reduce the incidence of high non- performing loans in the Ghanaian banking industry.

(k) It has been revealed that high non-performing loans was one of the major causes for the demise of both UT Bank and Capital Bank. The non-performing loans impacted adversely on the banks' capital, liquidity, and profit. Therefore, Ghanaian banks should work hard to improve the quality of their risk asset portfolios to enhance solvency, liquidity and profitability. Ghanaian banks should be careful about concentration risk, excessive risk taking and uncontrolled credit expansion which does not taking into account loan deposit ratio, credit administration procedures and loan recovery ability.

(l) Efficient management of banking operations can help to reduce the high operational costs which erodes the bank profits. Bank occupancy costs and staff related costs remained major components of the operational costs in the Ghanaian banking industry. Banks must be encouraged to employ more information technology to automate their service delivery. The use of ATMs, POS terminals and other electronic facilities would help to reduce their branch network. Moreover, the use of technological facilities would enable banks to explore new markets without maintaining physical presence. The electronic banking facilities would reduce the staff costs, occupancy costs

and queuing times in the banking halls that would improve the cost to income ratio. Banks must also collaborate with Telecommunication companies to improve on their service delivery and money transfer facilities. Banks must take steps in building their capacity in information technology staff to reduce the high costs of foreign consultants who demand high fees for software licence and maintenance contracts. Managerial costs and executive compensation schemes should be at an optimal level and consistent with profit maximization objectives of shareholders.

m) Banks should be liquid which should be evidenced by the operational measures such as liquid assets to the total deposits and liquid assets to volatile funds. Positive figures will indicate the banks have adequate cash and near cash to meet any changes in banks' monetary obligations as well as to supply financial resources to support future operations. Banks should not depend heavily on public sector deposits to finance their assets growth, if the central government, ministries, departments and agencies (MDAs) were to withdraw their deposits from commercial banks they could see their liquid assets to risk assets ratio falling below the acceptable level. Banks must also cultivate the culture of sound asset and liability management. If this is done they would be able to appreciate when to apply "breaks" in terms of loan disbursals. According to IMF country report (2011, 11/121), more

generally, small banks are exposed to liquidity risk than big banks. This is because bigger banks have a network of branches through which they are able to tap low cost deposits, while smaller banks rely on public sector and other whole scale deposits.

n) Weak corporate governance, poor risk management and fraud played a significant role in bank failures. There is the urgent need for the Bank of Ghana to implement a mandatory code of corporate practices for the universal banks, and NBFIs. There must be appropriate punitive measures and sanctions for non-compliance. Banks should hard to promote and adhere to good corporate governance practices. They should allow corporate governance structures and principles to work without any interferences,

(o) Financial weaknesses are not the only source of bank failure. They arise due to economic environment in which the bank operates; weaknesses in internal controls; poor management; ineffective board practices; regulatory failures, weaknesses outside support institutions such as deposit insurance schemes; and the attitude of monetary authorities which reflect both in the financial weaknesses and eventual failure of a bank. All these factors contributed to the failure of UT Bank and Capital Bank.

p) Strong and comprehensive legal framework is imperative in fighting financial malpractice and recovering debts owed to banks. Despite the establishment of commercial courts and Bank of Ghana's collateral registry, banks reported experiencing prolonged and protracted delays in foreclosing on collateral used as security. In particular, complex and time-consuming procedures for taking possession of collaterals pledged as securities for banks' loans and advances had contributed to low debt recovery rates which resulted in the huge non-performing loans in Ghana over the past decade.

q) Poor corporate governance practices had been identified as one of the key factors that led to the failure of UT Bank and Capital Bank in 2017. Hence, Ghanaian banks especially the local banks should do well to promote good corporate governance practices. They should rather allow corporate governance structures and principles to work. For instance, in line with good governance practice, the board of directors should not interfere with the senior management day to day operations. There should be clear distinction between the roles of boards and senior management of the banks. Boards should focus on strategic policy direction, monitoring and evaluating performance of the banks and also give approval to certain key decisions among others.

6ii) Lessons for the Bank of Ghana as a regulator and supervisor:

(a) Bank of Ghana should establish a very strong supervisory framework. This will involve the enhancement of the supervisory capacity, adoption of risk-based supervision, consolidated supervision, and strict enforcement of laws and regulations. The Bank of Ghana will have to establish an internal risk management specialist function to develop Ghanaian capital adequacy and enterprise risk assessment process guidelines, based on the ICAAP (UK) and COSO (USA) frameworks, to ensure the industry adapts and complies with the highest standards of risk management and board are well informed on how their organizations are managing risks (enterprise-wide risk management).

(b) With the implementation of universal banking concept in 2003, it should be imperative that accounting as well as disclosure requirements of financial institutions be enhanced. There was also the need for regulatory agencies including Bank of Ghana to review information disclosure requirements so as to minimize information asymmetry between banks and investing public. This is necessary to ensure that business decisions by the investing public are well informed under universal banking concept. Adequate information disclosure requirement will force

Ghanaian banks to pay greater attention to reputational risk that could result in loss of confidence as well as patronage. As necessary step to promote market discipline, it is imperative that the full weight of the provisions of applicable laws be brought to bear on erring operators in order to help promote safe and soundness banking practices under the universal banking model.

b) Bank of Ghana should set up an Early Warning System as well as an effective failure resolution structure. In this regard, the Bank of Ghana and SEC should finalise a Contingency Planning Framework. Bank of Ghana should incorporate forward looking tools (e.g. early warning systems; reviews of governance and management and stress-testing) to identify distress and weak banks at an early stage. The framework consists of policies and measures for the prevention, management and containment of banking crisis. The implementation of the plan will assist Regulatory Authorities to reduce the likelihood of the occurrence of systemic crisis and provide transparent and objective criteria for intervention thereby reducing the incidence of regulatory forbearance. At the institutional or bank level, a number of issues would need to be considered. There will be need for stronger corporate governance, more trained and skilled operators and greater improvement in risk management practices. Banking institutions

identified as potentially risky by the Bank of Ghana (BSD) must be typically subjected to greater supervisory surveillance and frequent on-site examinations.

c) The Bank of Ghana's regulatory policy should not rely exclusively on the imposition of prudential requirements, rules and regulations, but should also focus on aligning the incentive structure facing shareholders and senior management of local banks with prudent and honest management (Caprio, 1996).

d) Bank of Ghana needs an early preparation for the distress situations. Deterioration in the perceived position of a bank can occur rapidly. For this reason, it is important that Bank of Ghana take early preparatory steps to ensure that it is well-equipped to respond to crisis in the distressed banks. For banks that are systemic, additional preparation for distress situations, by the Bank of Ghana and by banks themselves is particularly important. Systemic banks must be obliged to draw up recovery plans demonstrating how they would tackle distress situation and which measures they would adopt to avoid bank failure. Bank of Ghana should also be required to identify systemic banks in Ghana, benchmark and challenge banks' recovery plans and prepare for failure of a systemic bank by having resolution plan ready.

(e) Bank of Ghana should be more pro-active and intervene at the early stage of distress, because experience from other countries have shown that regulatory and supervisory forbearance exacerbates the problems of distressed banks allowing them to grow rapidly and become more widespread and systemic. Bank of Ghana should avoid potential systemic problems. To avoid distorting competition in the Ghanaian banking sector, all banks operating in the country should, in general be subjected to the same supervisory and regulatory standards. This applies in normal times as well as distress situations. However, a more intensive regulatory framework may have to be adopted by the Bank of Ghana that may have to be applied to systemic banks for good reasons. Systemic banks have bigger inter-bank linkages and carry out a wider range of activities, often including cross border operations. They also tend to be large, so a failure will create greater spill over effect. But systemic problems do not arise only with large bank. They may arise when a number of small banks fail simultaneously or where a small bank has a critical position in a particular market segment. Equally, a large bank's failure may not have systemic consequences.

f) There will be need for stronger and well- funded Deposit Insurance Fund to strengthen the public safety net. The government and Bank of Ghana must look at operational modalities of Ghana's Deposit Protection Act 2016 Act

931 as done by the Central Bank of Nigeria and Nigeria Deposit Insurance Corporation (NDIC).

g) Bank of Ghana should set stricter criteria for board membership based on Core Principle 3 of BIS (2006) and Section 44; (4) of the Banks and Specialised Deposit Taking Institution Act 2016 Act 930 so that banks may appoint only those who have sense of responsibility towards improving corporate governance practices and who are sympathetic to the promotion of the Ghanaian banking industry. They should not be “rubber stamp or yes men” board members and should have knowledge of the financial and economic facts and experience of working in the Ghanaian financial sector. They should also be well informed of a country specific and international regulatory rules and laws which have implication for the bank

h) There will also be the need to promote greater accounting and disclosure requirements to minimise information asymmetry between banks and the public to ensure that business decisions are well informed. This is even more relevant in view of the New Capital Accord (Basel 11& 111) which emphasizes greater market discipline.

i) Better and stronger credit or borrower culture must be promoted and sustained. There must be better understanding between debtors and

creditors that they have duties and responsibilities toward each other. The judicial process must also be supportive in this regard. It is also expected that the web-enabled Credit Risk Management System managed by Bank of Ghana will facilitate credit risk management.

k) Bank of Ghana should have adopted consolidated supervision after the adoption of universal banking model in 2003. Consolidated supervision is a comprehensive supervision is a comprehensive approach to banking supervision which seeks to evaluate the strength of an entire group to which a bank belongs, taking into account all the risks which may affect the bank regardless of whether such risks are carried in the books of the bank or the related entities (Bank of England, 1998). The emergence of universal banking concept in 2003 has no doubt made it necessary for consolidated supervision that requires consultation and cooperation amongst the various regulatory agencies in the Ghanaian financial system. The need for such a consolidated supervision is long over- due, because it would minimise regulatory arbitrage, facilitate information sharing as well as joint supervisory action where necessary. Presently, banks and other financial institutions report their activities to their respective regulators in the financial system, utilising formats approved by each regulator. The implementation of universal banking requires a more comprehensive format to capture all the

activities of a bank firm while on site examination should cover all the operations of financial conglomerates. It is imperative that the present reporting format of banks be reviewed so as to incorporate all the possible activities that banks are likely to undertake under the universal banking. This will make it possible for Bank of Ghana's Banking Supervision Department to obtain global view of the bank's operations as well as prevent the submission of different sets of returns to the different regulatory bodies which would give a misleading picture of the affected bank's activities.

l) The Bank of Ghana and Economic and Financial Crimes Agency in collaboration with the Special Prosecutor Office should go after the owners, board of directors and senior management of these failed banks and NBFIs who are found culpable. Ghana had previously allowed looters and greedy board members, and management to go scot free to enjoy their ill-gotten wealth. For instance, what happened to owners, board members, senior management and other staff who caused the collapsed of DKM, Express Loan and Savings Ltd, Ghana, Bank for Housing and Construction ltd, and Ghana Cooperative Bank ltd.

m) Bank of Ghana should adopt tougher sanctions for non-compliance with primary reserve requirements, capital adequacy ratio, and all other prudential requirements. Banks for which their directors and management

found culpable for persistent non-compliance can personally liable and also be charged for criminally liability, instead of the administrative penalty of not more than 500 penalty units stated in the Banks and Specialized Deposit Taking Institution Act 2016 Act 930.

6iii) Lessons for local institutional investors such as SSNIT, other pension funds and insurance companies.

There is a useful role of local institutional investors in the development, growth and smooth-running and avoidance of crisis in the banking sector. As opposed to numerous small shareholders in the domestic private banking sector, the local institutional investors hold a significant minority shares that allows them to influence the decision-making process at the bank through their representation on the board of directors. Since the local institutional investors usually possess more diversified shareholding in various other banks and companies, the motivations for their actions are different from other shareholders. As opposed to small shareholders, institutional shareholders are financially stable. As opposed to majority shareholders, their interests are not tied only with the bank, but with success of the entire Ghanaian banking industry in general where they hold stakes. Therefore,

their influence on decision making could prove to be beneficial. A very important lesson, similar to what has been stated earlier for the other board members, is that the representatives or members appointed by the local institutional investors to the board of directors on domestic private banks should have requisite knowledge and experience. In this context, knowledge of the local and international banking regulation, experience in banking and finance should be given priority over other factors.

b) Awareness of good corporate governance is generally low in the financial industry and most shareholders do not know their rights. There is not enough shareholder activism. Shareholder activism is the way which shareholders can assert their power as owners of the company to influence its behavior. Activism covers a broad spectrum of activities. Activities include "voting with one feet" exit, private discussions or public communication with corporate board and senior management, press campaigns, blogging and other electronic ways of public "naming and shaming", openly talk to other shareholders, putting forward shareholder resolutions, calling shareholder meetings, and ultimately – seeking to replace individual director or the entire board of directors. For example, at the bank's annual general meetings there is not enough probing of non-executive directors as well as independent directors on the operations of the banks they have invested in. Shareholders'

associations should be encouraged so that members can be educated on their rights.