REMITTANCES STRATEGY FRAMEWORK FOR SUSTAINABLE DEVELOPMENT IN SIERRA LEONE

CONTENTS

Acknowledgements

This report was prepared by Sanjay Krishnan, Juan Pablo Paschoa, John Weeks and Jan Toporowski for the Government of Sierra Leone with support from the UNDP. We wish to record our gratitude to Adusei Jumah, Radha Upadhyaya, Sylvia Siango-Apreku, Michael Schulenburg, John Conteh, Juan Costain, Michel Sho-Sawyer, Steven Ursino, Samuel Harbor, Edward Koroma, Ensa Koroma, Ibrahim Rogers and to the many people listed in the Appendix for their generous assistance in completing this report.

EXECUTIVE SUMMARY

Remittances constitute an important source of foreign currency inflow into the Sierra Leone economy. In preparing its second Poverty Reduction Strategy Paper (Agenda for Change), the government has taken into consideration the close links that exists between migration and development. The Government encourages Sierra Leoneans in the Diaspora to contribute to the fight against poverty not only through skills transfer but also by remittances, investment and expenditure, entrepreneurial activities and building capacities in higher education.

Currently, an estimated 86% of overseas Sierra Leoneans send money home regularly to an estimated tune of around \$168m annually or around 12% of GDP. Government calculations place the number between \$250 and \$400 million, or 20-25% of GDP which would be among the very highest in Africa. The true size of remittances, including unrecorded flows through formal and informal channels to Sierra Leone, is therefore considerable.

This report identifies the methods by which remittances are sent to Sierra Leone, namely through money transfer operators, such as Money Gram and Western Union. However, these remittances account only for a minority of the remittance transfers into the country. A small proportion of the remainder is transferred by mobile phone credits, and the bulk of the remainder enters the economy through unofficial remittance agents operating on behalf of merchants in the country.

The key issue arising out of these remittance flows lies in the foreign exchange component of remittances sent through informal channels. That component of informal remittances is either held outside Sierra Leone or acts as a cash reserve for informal banking in the country. This promotes dollarization and reduces the effectiveness of formal banking and the monetary policy conducted by the Bank of Sierra Leone. Moreover foreign exchange held abroad or in the informal banking system may not be used as security for the issuance of foreign exchange obligations (securitisation) that could finance the reconstruction and economic development of Sierra Leone.

This report recommends the following measures to extend the range of remittance facilities available to citizens of Sierra Leone resident abroad; to draw foreign currency back into the formal banking system; to mobilise the foreign currency component of remittances for reconstruction and development; to improve financial reporting; and to regulate informal remittance agencies. We emphasise that **these recommendations do not reduce the right of the senders of remittances to determine the amounts and beneficiaries of remittances. Nor do these proposals limit in any way the right of beneficiaries to determine the legal purposes to which they may choose, or agree with the sender, to devote their remittances.** These proposals are designed to combat fraud and money-laundering by increasing the transparency and reporting of remittances and to mobilise the foreign exchange component of remittances for reconstruction and developmental purposes.

a) Reduced limits on individual bank transactions to restrict the flow of cash into the informal banking system.
b) The extension of foreign exchange bureau licences to allow such bureaux to receive remittances subject to a modest minimum capital requirement, a requirement to report total transfers received or sent as well as individual transfers in excess of US$10,000, or transfers to or from countries 'blacklisted' by the Financial Action Task Force. However, the licence extension should not extend to deposit-taking or making loans, which bureaux would continue to refer to licensed banks.
c) Public utility companies in Sierra Leone should offer for sale, through approved issuing banks in the UK and US, **Exchange Rate Linked Bonds** (ERLBs), in accordance with the securities legislation of the UK and the US respectively. These would be payable in relatively small amounts, say US$100 per bond. Interest, at a rate of, say, 5%, and principal would be payable in Leones to a nominated beneficiary in Sierra Leone over a period of five to eight years. Interest and principal would increase in proportion to changes in the exchange rate between the Leone and the US$, so that the bonds would keep their effective dollar value. The maturity period should allow the issuing utility company to refinance ERLBs by placing longer term bonds on the Sierra Leone Stock Exchange. To assure the liquidity of ERLBs, their beneficiaries should be allowed to obtain early repayment of the principal by selling the bonds to the National Social Security and Investment Trust, at a discount of, say, 10%.

d) Citizens of Sierra Leone resident abroad should be allowed to open **non-resident foreign currency bank accounts** in licensed commercial banks in the country. Interest should be payable on these accounts at a rate slightly below the rate offered on ERLBs.

e) **Terminating credit societies**, based on the traditional *osusu* system, to finance house-building or school fees, should be established with the possibility of receiving contributions from Sierra Leone citizens living abroad. These should be registered and audited to prevent fraud.

f) To finance infrastructure repair and improvement and social services such as education and health, the Government of Sierra Leone should issue **Diaspora Bonds** in amounts of, say US$100 each. These would have a maturity of between five and eight years and pay interest at a rate of, say, five per cent. Interest would be rolled up and paid together with principal in dollars on maturity. We recommend that matching loans be provided the World Bank and multilateral financing agencies.

g) Eventual issue of foreign currency securities backed by the foreign exchange components of remittances and donor aid flows. The latter would require greater and longer-term commitments by aid donors.

h) We recommend 'milestones' for financial development to support these new financial instruments, including reporting of and data on remittances, and target levels of foreign currency deposits with commercial banks; households with bank accounts; sovereign bond issuance by the Government of Sierra Leone to establish a benchmark credit rating for future securitisation; reductions in diamond-smuggling; and the successful refinancing of ERLBs on the Sierra Leone Stock Exchange.

i) Finally, we recommend coordination between the Bank of Sierra Leone and other central banks in Africa, Asia and Latin America to share experience and build capability in managing informal banking and remittances.

1. Introduction

1.1 The role of emigrants' remittances is an important issue for researchers and policy-makers in poorer labour-surplus countries. For those countries, the remittances of migrant workers represent a substantial flow of financial resources predominantly from richer countries to the less well-off countries with substantial labour reserves. By generating recurrent foreign exchange transfers to the country to which they are sent, remittances can provide a source of foreign currency reserves and improve the credit-worthiness of the government or banking system for external borrowing where new financing mechanisms, such as securitisation, can expand access to capital markets and lower borrowing costs. The actual remittances have supported families of migrants, financed housing construction and small businesses, as well as assisting with the provision of social infrastructure such as schools and hospitals. In the case of Sierra Leone, the significance of foreign remittance flows is enhanced by the social composition of the country's Diaspora, among whom may be found many highly qualified and professional workers, and by the poor condition of the economy following a decade-long civil war.

1.2 Governments throughout Africa have recognised the potential of their Diasporas. For example, the Ghanaian government has, among other efforts, passed citizenship legislation granting eligible overseas-resident Ghanaians the right to vote. Descendants of the historical Diaspora may now visit Ghana without visas after their first visit. It is projected that sub-Saharan African countries can potentially raise $1-3 billion by reducing the cost of international migrant remittances, $5-10 billion by issuing Diaspora bonds, and $17 billion by securitizing future remittances and other future receivables (Ratha et al., 2008). In Sierra Leone, the government has created an Office of Diaspora Affairs within the Office of the President, to sustain the interest of citizens of the country who are currently living and working abroad.

1.3 The Sierra Leonean Diaspora is the result of the movement of population forced by hostilities during the country's civil war. That war led to the loss of thousands of lives, but also to migration as thousands fled the country. According to United Nations (UN) figures, it is estimated that approximately 30% of the educated nationals left for other countries, mainly the USA, the UK and mainland Europe. The war also forced thousands of Sierra Leoneans to take refuge in the other Mano River Union States as well as in Gambia, Ghana and Nigeria.

1.4 This level of migration has brought with it a significant increase in remittances, especially from nationals living in Europe and North America. Arguably, remittances have become the main source of aid in Sierra Leone. However, the lack of a formal structure has reduced its potential impact. As in most developing countries, the data on remittances is grossly inaccurate. A high percentage of remittances pass through informal channels. The Diaspora is estimated by the UNDP at close to one million of which 60-70 percent is first generation. About two-thirds of households have either a family member or close friend or relative remitting funds. Nearly 70-80 percent of the funds remitted are spent on consumption goods—most of which are imports. Thus the country serves as a transit point for the remitted funds, instead of an end destination. All this presses for the need to put a remittances strategy in place (UNDP 2009).

1.5 In preparing its second Poverty Reduction Strategy Paper (Agenda for Change), the government has taken into consideration the close links that exists between migration and development. The Government encourages Sierra Leoneans in the Diaspora to contribute to the fight against poverty not only through skills transfer but also by remittances, investment and expenditure, entrepreneurial activities and building capacities in higher education (Government of Sierra Leone 2008).

1.6 Remittances therefore play an important role in the Sierra Leonean economy, with an estimated 86% of overseas Sierra Leoneans sending money home regularly. IFAD has estimated annual flows to around $168m annually or around 12% of GDP, which would be the 9th highest in Africa (IFAD 2009). Government calculations place the number between $250 and $400 million, or 20-25% of GDP which would be among the very highest in Africa (UNDP 2009). The true size of remittances, including unrecorded flows through formal and informal channels to Sierra Leone, is therefore considerable (ibid.).

1.7 This study examines the factors that affect remittance flows, now and in the future, including the influence, if any, of factors such as rates of return on various assets, or return differentials, in particular interest rate differentials on comparable deposit accounts offered in the host and home country, possible incentive interest rates offered on home country deposits, the black market exchange premium (if any), the return on real estate in the home country, inflation rates, and other factors including political risk and uncertainty that may affect the decision to remit. The study recommends policies and regulations that will help reduce transaction costs associated with remitting as well as reductions in illegal money transfers. Proposals are made as to how the formal financial infrastructure supporting remittances can be strengthened; how incentives can be improved to make remittances legal; and how to mitigate the problem of foreign exchange bureaux making illegal money transfers. The study suggests ways in which remittance channels may be organized in order to improve access to financial services. Finally, the study recommends ways in which remittances may be channelled in such a way as to assist in the economic and social reconstruction and development efforts of the public and private sectors in the economy.

1.8 The study deems the last recommendation as the most significant challenge for remittance policy. Remittances are made by private individuals for purposes which those individuals decide, in conjunction perhaps with the recipient of the remittance. The ability to control the purpose to which a remittance is applied is, along with the need of the recipient, perhaps the most important incentive for sending remittances. Any government attempt to direct remittances is bound to be counter-productive, in the sense of reducing that incentive to make remittances. However, the authors of this report believe that by extending the range of remittance facilities and bringing informal remittances into the scope of the formal banking system, access to financial services may be extended, and additional funds mobilized for reconstruction and development, without imposing any additional controls on remittances.

1.9 The Report proceeds as follows. In section 2, key features of the developmental and reconstruction need of Sierra Leone are outlined. Section 3 examines the actual remittance flows from abroad into Sierra Leone. Section 4 examines the factors that point to future instability or decline in remittances. Section 5 addresses issues of the financial strategy or securitizing remittance flows. Section 6 suggests measures to bring foreign exchange back into the formal banking system from the informal banking system. Section 7 suggests 'milestones' by which financial development may be measured in preparation for future securitization. Section 8 discusses the changes that need to be made to banking regulations in order bring remittances into the formal banking system. Section 9 examines the exchange rate and interest projections that underlie the recommended strategy. Section 10 appears in response to a suggestion made to us by a senior government official in Freetown, and reflects on the ability of the financial and banking authorities in Sierra Leone to develop local capability for drawing up such financial strategies. Section 11 concludes and lists the recommendations of this Report.

2. Developmental and reconstruction need

2.1 Recent GDP growth figures indicating that national income in Sierra Leone has been growing in real terms at between 6 and 8% (Weeks 2009; IMF 2009) underestimates the scale of the economic reconstruction and development required by the country and its people. Nearly ten years after the end of a devastating civil war, Sierra Leone remains one of the countries at the bottom of the Human Development Index list, with one of the most unequal distributions of income in the world (Weeks 2009, Jumah, 2009). It is very apparent to anyone visiting the country that the poor state of the country's infrastructure (its roads, harbours, drainage, and so on), housing and public services (such as hospitals, and schools), and public utilities (water and electricity supply) are all major obstacles to the kind of sustainable economic development that can combat poverty and raise living standards among those on lowest incomes. Without improvements in infrastructure, housing, public services and public utilities, Sierra Leone can develop urban, consumer demand in urban areas, fed by imports and partially financed by aid, remittances and commodity exports. But this growth will be fragile and will fail to improve living conditions among those living in rural areas and the poorest part of the urban population (see Solà-Martin 2009).

2.2 This report examines the inflow of remittances into Sierra Leone and suggests ways in which the foreign exchange counterpart of that inflow can be used to improve infrastructure, housing and public utilities. **It should be emphasised that the proposals given in this report do not divert remittances from the support of families and communities as intended by the senders of those remittances.** Some concern was expressed to us in Sierra Leone that remittances are being used solely for consumption. In fact some remittances, but an unknown proportion of the total, are sent to finance the setting up small enterprises. Other remittances are contributions to schools and social infrastructure sponsored by faith or kinship groups. All of these are valuable contributions to economic reconstruction and development that need to be retained. Furthermore, we strongly believe that senders of remittances should retain the power to send their financial support to family and friends at their own discretion and in the amounts they choose. Attempts by the banking authorities to direct remittances too obviously would be counterproductive. Such attempts would discourage remittances and merely encourage informal banking to develop new techniques of evading controls. The recommendations in this report, if implemented, would extend remittance choice by offering new, more secure and cheaper means of sending money to family and friends in Sierra Leone. It is the foreign exchange counterpart of remittances that we propose should be harnessed for developmental purposes. At present that counterpart currently provides the reserves for a large informal banking system. We recommend measures to divert these reserves into the formal banking system and more productive use in the reconstruction and development of an economy more capable of supporting the people of Sierra Leone with domestic production and exports. This report therefore complements and extends the analysis and recommendations laid down in the recent *Sierra Leone Financial Sector Development Plan* (Bank of Sierra Leone, 2009).

3. Remittance Flows

3.1 Remittances are defined as private unrequited transfers (i.e., payments for which no economic asset or benefit is obtained) sent from abroad to families and communities in Sierra Leone[1]. Such transfers now constitute a significant part of the financing of economic activity in the country, and an important source of support for a very large proportion, if not the majority, of the population. However, remittances are sent largely through informal channels. Only remittances sent by official money transfer operators, such as Money Gram and Western Union are recorded as such in the reports sent by banks to the Bank of Sierra Leone. A recent study estimated that Sierra Leone received US$168 millions in remittances or 12% of GDP (UNDP 2009). Only between a quarter and a third of this amount is officially reported through the banking system (DfID 2008). Most of these remittances come from the United Kingdom and the

[1] More generally, a remittance is a transfer of money by a foreign worker to his or her home country.

United States of America, where it is estimated that the overwhelming majority of the Sierra Leone diaspora is currently resident.

3.2 The method of transfer of remittances is obvious only in the case of the minority of remittances that is sent through formal money transfer operators. Remittances that are sent through informal channels are sent principally by three means. Some is taken directly in cash by visitors flying to Freetown for delivery to relatives or friends in Sierra Leone. This may be a relatively small amount, because of the high cost and inconvenience of air travel. But this category of remittance would also overlap with cash sums being taken by merchants and business people visiting Sierra Leone.

3.3 A second method is by mobile phone transfers. This involves crediting the mobile phone account of the owner of a mobile in Sierra Leone with an amount of money that may be withdrawn at an agency of the mobile phone company. This may be done by bank credit in the sender's country, or even by charge card. One mobile telephone company in Sierra Leone already offers a service (called Splash) making such payments. A leading mobile phone company in Sierra Leone plans to launch its own payments and bank deposit system next year. The plan includes partnership with domestic banks where the mobile company will have a consolidated banking account on behalf of their customers. The company will therefore be the counterparty against the banking system, and the remittances flows will enter the banking system. It will therefore be necessary to extend banking regulations to mobile transfers (see section 8).

3.4 The third method of making informal remittances is through merchants' agents. There is now an established system of agents operating in the UK and US who will accept remittances on behalf of merchants in Sierra Leone. The person sending the remittance is given a number which is given to the beneficiary by mobile text message or by email together with the name of the merchant from whom the remittance may be collected. The beneficiary goes to the merchant, gives the number and his/her name, and collects the remittance. The merchant gains from the transaction in now having a credit, through the agent in the UK or US, in those countries. That credit may be used to buy and ship goods to Sierra Leone. This is therefore a secure and reliable method of transmitting the money. The merchant has an incentive to make the payment because he/she wants repeat business to secure continued credit in the US or UK.

3.5 A fourth method of making informal remittances is through foreign exchange bureaux. By law, foreign exchange bureaux are not allowed to receive or make remittances on behalf of customers, since the bureaux are only licensed to make spot purchases or sales of foreign currency. We recommend in section 8 that the bureaux are given limited licences to make and receive remittances. The transfer of illegal remittances through foreign exchange bureaux can be justified by their lower transaction costs for such transfers and the failure of the banking system during the civil war to honour their customers' deposits. However, in the process of financial reconstruction, it is necessary to ensure that remittances sent through foreign exchange bureaux are recorded and, if deposited, find their way into the formal banking system.

3.6 Informal remittances are effective in supporting families and some community development in Sierra Leone. Their economic disadvantage lies in the fact that they keep foreign currency outside the formal banking system, either as a cash reserve for the large informal banking system in the country, or as merchants' effective holdings of foreign currency abroad. This means that the foreign currency is not available to be purchased by the Bank of Sierra Leone to add to official foreign exchange reserves, where it could be used to support the management of official foreign borrowing; nor is that foreign currency available in the formal banking system, where it might support strategies of securitisation that would allow commercial banks to engage in foreign currency lending to businesses located in Sierra Leone. Effectively these informal remittances encourage purchasing of merchants' supplies from abroad, even where the goods may be locally or regionally produced. Furthermore, the concentration of foreign currency as cash reserves for informal banking in the country, and as credit held abroad, facilitates diamond smuggling, money laundering and capital flight. It is a key factor in the informal dollarization of the economy, reducing the effectiveness of formal banking and monetary policy and exposing the whole economy to currency and credit instability. In summary, the informal remittance system, alongside supporting families and communities in Sierra Leone, discourages domestic production and exports, and is a corrupting influence on the system of banking.

4. Fragility of remittance flows

4.1 A key consideration in using remittance flows as backing for securities issuance is the stability of those flows. Over the first three quarters of 2009, the country experienced a thirty per cent fall in recorded remittances. We do not believe that this drop is entirely due to the transfer of these flows into informal remittance channels. There are a number of factors that suggest that future remittance flows will be volatile, and may even decrease over a longer period.

4.2 An important factor in causing a fall in remittances will be the continuing economic difficulties in the U.S. and U.K., where the majority of the Sierra Leone diaspora has settled, however temporarily. Most of these refugees will be affected by rising unemployment and falling incomes among those receiving the lowest incomes.

4.3 A related factor that will reduce future remittances will be the return of refugees to Sierra Leone, as the situation in that country stabilises, as employment possibilities in the U.S. and in the U.K. deteriorate, and as refugees fulfil requirements to obtain U.S. and U.K. travel documents, which offer better trading prospects in Sierra Leone. An important factor here is the emergence of skill shortages in Sierra Leone, attracting back middle class Sierra Leonians unable to find work in their professions abroad.

4.4 Some part of the diaspora will settle permanently in the U.S. and the U.K. Given the high cost of housing in those countries, those who settle permanently in the U.S. and U.K. are likely to concentrate their savings in the housing market where they are living, rather than in Sierra Leone.

5. Strategy and Securitisation

5.1 There are essentially three strategies by which the foreign exchange counterpart of remittances could be brought into the formal banking system and directed towards productive use. The first of these is a broadly 'constructivist' strategy of building up the institutions of a formal banking and financial system (see, e.g., First Initiative 2005), increasingly integrated into the international financial system and capable of effective techniques of financial mobilisation such as securitisation. Among these would be a move to the speedy securitisation of remittances. This is unlikely to be successful because of the large proportion of remittances that are informally transferred and placed in the informal banking system, and because of the absence of appropriate institutional infrastructure (see 5.6 - 5.12 below).

5.2 The financial construction described above may be contrasted with a more socially 'embedded' (but not necessarily less radical) approach in which financial development arises more organically from local initiatives such as the *osusu* credit system, or microfinance institutions. Informal remittances are broadly supportive of such initiatives in that the remittances may provide money for payments into locally organised credit institutions. However, it is doubtful whether such initiatives could concentrate funds on the scale required to finance the infrastructure, public services, housing, and public utilities that constitute the key bottleneck in the economic development of the country. Moreover, these local schemes could easily become conduits for smuggling and money laundering, unless such initiatives are strictly controlled. But strict financial control would severely constrain the local social control necessary for the success of such initiatives. Some proposals are made in paragraphs 6.4 and 6.5 below.

5.3 We would recommend a much more targeted strategy in which particular financial instruments are introduced to bring the foreign currency market back into the formal banking system, and to mobilise the foreign currency counterpart of remittances for purposes of economic development. This would be combined with a system of monitoring and 'milestone' indicators of progress along a path towards a robust and developmentally effective financial laid out in the targeted strategy. This strategy is outlined below, and detailed in sections 6 and 7 below.

5.4 Remittances have been securitised as part of so-called Diversified Payment Rights (DPR) transactions for more than a decade. Some examples of recent DPR transactions are MDM DPR (Russian DPR transaction originated by MDM Bank in the Russian Federation) and DFS Funding (Turkish DPR transaction originated by Denizbank in Turkey). In a typical DPR securitisation, a person outside the host emerging market country sends USD-denominated payment (remittances or payment for imported goods) to a beneficiary in the host emerging market country. The payment goes through a payor bank in the foreign country and a bank in the host country and ultimately reaches the beneficiary in the host country. It is quite possible that the bank in the host country already has a nostro account in the payor bank in the foreign country and thus all cash settlements in foreign currency are done offshore through the nostro account. The beneficiary can either receive the payment in USD (and converts it into the host country's local currency) or the bank receives the payment in USD but the beneficiary can only receive the payment after it has been converted into the local currency. The payments from start to finish go through the international and domestic banking system and is tracked every step of the way. The cash flows (which are the receivables that are securitised) accrue as a result of payment orders that the bank in the host country (called the originating bank) receives from such banks. The payment orders are type MT100 or MT200 type orders instructing the originating bank to pay certain amounts to the beneficiary in the host country.

5.5 Key features of DPR transactions are: a) The securitised receivables are the originating bank's expected payments from offshore correspondent banks (or depositary banks). The originating bank is in the host emerging market country while the depositary banks are typically located in countries that contribute the most in terms of remittances and trade; b) Remittances are typically only around a tenth of the cash flows. The remainder of the cash flows consists primarily of trade flows diversified across various sectors. The sectors contributing to the cash flows are determined by the overall flow of funds in the economy and the originating bank's loan portfolio. Some FDI and FPI inflows may also form part of the cash flows; c) The target rating for DPR issuances is typically investment grade. DPR bonds may also be rated above the rating of the host country if the sovereign (of the host country) is expected not to interfere or attempt to divert the cash flows away from paying the bondholders. The rating of the DPR bonds is contingent upon a qualitative and quantitative assessment about the sustainability of such cash-flows in the future in a stress scenario (commensurate with the target rating of the bond); d) The bonds are typically denominated in Dollars or Euros (depending on the investor base).The cash flows are also typically accrued in dollars, Euros and Sterling. The transaction could be wrapped (using payment guarantees provided by multilateral agencies) or unwrapped.

5.6 There are several issues that need to be addressed before embarking on a programme of securitising remittances in Sierra Leone. At present a significant portion of the remittances flows through informal channels that are outside the Sierra Leonean banking system. As a result these informal cash flows that are not of the type of the typical payment order are not available for securitisation. Although the foreign currency denominated cash that is brought informally into the country may end up in the formal banking system, the flows are not tracked as remittances and thus cannot be used to back securitisation bonds. Accordingly the most appropriate setting for securitisation is a phased strategy of first bringing remittances into the formal banking system and establishing the institutional preconditions for securitisation before attempting the issue of remittance-backed securities.

5.7 Securitisation involves concepts of true sale, i.e. a framework surrounding the sale of existing and future claims originated by an entity in Sierra Leone to an offshore Special Purpose Vehicle (SPV). The concept of true sale, claims on cashflows that have not yet been generated (but will be generated in the future), and enforceability of the assets need to be supported by legislation in Sierra Leone.

5.8 At present the remittances are volatile and have fallen in the last 6 months driven by a number of factors such as the global financial crisis affecting the Sierra Leone diaspora living outside Sierra Leone. In order to securitise the receivables, the remittances need to be relatively stable and diversified by country of origin and possibly even by currency of origin. Such stability and diversification would enable the cash-flows (and thus the securitisation) to withstand levels of stress commensurate with the target rating level and will thus enable placement of such bonds.

5.9 In a typical DPR transaction, a commercial bank in the emerging market country originates the cash flows that form the asset base for the securitisation. In the case of Sierra Leone, it is possible that a commercial bank in Sierra Leone receiving the remittances may originate the cash-flows to be securitised. However it is our belief that cash-flows that can be originated by a single bank in Sierra Leone may be insufficient or unpredictable to be the basis for securitisation.

5.10 The cost of arranging such transactions, marketing fees, listing fees, administration fees, and fees paid to various parties such as legal counsel, rating agencies, etc. can prove to be significant. These costs have to be borne by the originating entity and may currently be considered too high.

5.11 Getting foreign investors to invest in Sierra Leone remittance-backed transactions could be challenging. Conventional investors in such bonds are either large private or supranational institutional investors. The role of supranational investors cannot be underestimated in the process of remittance securitisation. Supranationals are sometimes mandated to buy such bonds or facilitate the issuance of such bonds provided the note proceeds are used for certain types of lending such as lending to small and medium enterprises (SMEs). SMEs in developing countries quite often struggle to gain access to credit and such targeted and directed securitisations can be useful in providing such access where most necessary. Furthermore, supranationals may also provide guarantees or credit wraps, liquidity facilities, act as swap counterparties, etc. The willingness of supranationals to be part of such transactions provide incentives to other (private or otherwise) institutional investors to enter into such transactions. In the case of Sierra Leone, finding supranationals and private investors to invest in a Sierra Leone-based remittance securitisation could be difficult given the relatively low exposure of the country to such financing.

5.12 A further difficulty is the absence of benchmark credit ratings, such as a rating of externally issued Sierra Leone Government bonds. The lack of a sovereign rating would mean that investors do not have a benchmark for yield and risk. Furthermore even if the sovereign bonds were rated, this would likely be in the ‘B’ range. Remittance bonds issued by assets originated in Sierra Leone would, in all likelihood, not be rated investment grade. A non-investment grade bond, despite the high spreads this could entail, would be more difficult to market since institutional investors buy it would have additional capital requirements.

5.13 We therefore propose a two-stage process in which initially the remittance process is formalised, so that most, if not all of the remittances sent to beneficiaries in Sierra Leone go through the banking system (even in cases where remittances are received by foreign exchange bureaus in Sierra Leone). Once those remittances are in the formal banking system, the foreign exchange component that arrives at the banking system (before being converted into Leone) may be used as the asset base for the securitisation. The formalization process is likely to take a few years (5-10 years). In the meantime, we propose data to be collected that will be essential for eventual securitisation. The data to be collected to enable securitisation is detailed in 7.2 below. Furthermore payment orders for all remittances need to be tracked to enable securitisation.

5.14 We also propose that rather than use an individual bank to originate the cash flows to be securitised, a centralized financial institution, such as a development bank, could use the aggregated foreign exchange flows (passing through the entire banking and foreign exchange bureau system) to originate the cash flows for securitisation. Bonds issued by the development bank could be used to finance long-term development programmes such as infrastructure projects. The bonds should ideally have an average life of 5-10 years. The first bond issuance will be absolutely crucial with several institutional investors possibly waiting to see how long the bond issuance process takes, the stability (or otherwise) of the remittance flows, the data collection and reporting, the liquidity and pricing of these bonds and the behaviour of the government and Central Bank of Sierra Leone towards such offshore transactions. If any entity in Sierra Leone -- private or sovereign -- issues bonds before the remittance bonds are issued, the pricing and performance of such bonds will also play a crucial role in the investment decision-making process of such institutional investors.

5.15 It must be noted that whether concurrent or sequential, issuances of bonds of various characteristics would largely be a positive step in the process of the broadening and deepening of the financial sector in Sierra Leone. Upon successful completion of the first bond issuance, future bond issuances could be made out of the same programme or several other programmes could be instituted. For many countries in sub-Saharan Africa, commercial borrowing abroad would render their governments ineligible for the Highly Indebted Poor Countries initiative, or the Multilateral Debt Relief Initiative (HIPC/MDRI). However, the Sierra Leonean Government is in the unusual position of having very little foreign debt, so that it benefits little from HIPC/MDRI .

5.16 It should be made clear that the tapping of the foreign exchange component of remittances does not in any way reduce the remittances reaching the beneficiary. The sender of the remittance does not need to send any additional amounts in order to sustain securitisation.

5.17 Diaspora bonds and remittance bonds can both be harnessed for long-term projects such as financing infrastructure projects or providing long-term loans to increase the maturity profile of the assets in the Sierra Leone banking system. Diaspora bonds are typically unrated instruments that harness the relationship between two sets of players (a) the country issuing the bonds, and

(b) the diaspora of that country. As a result, diaspora bonds "play" on the emotional or patriotic attachment of the diaspora to the country and as such could offer returns that are lower than market rates. Issuance of such bonds also relies on the existence of a relatively well-off diaspora.

5.18 Remittance bonds, on the other hand, typically involve several larger investors, since the bonds issued are not bought by the diaspora but by several institutional investors. Such transactions provide important externalities such as learning from the process of arranging such transactions, diversification of investor base, the arms-length nature of such transactions, etc. Furthermore regular repeat issuances of bonds from remittance bond programmes are possible and commonplace.

5.19 It should also be pointed out that remittance bonds would not crowd out the placing of diaspora bonds. There is enough room for both given that remittance bonds harness current and future remittances that flow through the formal banking sector while diaspora bonds are a way of raising funds for earmarked infrastructure projects.

5.20 The Sierra Leone banking sector relies excessively on relatively short-term deposits (less than 1 year) for its funding base. The only other source of long-term funding at present is the pension and social security contributions of employees which is currently being harnessed by NASSIT (the sole development bank in Sierra Leone). Increasing numbers of retirees in the medium term, any increase in the informalisation of the economy and other factors could significantly affect the ability of development banks to rely on such sources of funding. A diversified funding structure is necessary in the long run in Sierra Leone. Such a diversified fund structure would include the stock market, bond markets, and long-term deposits (in local and foreign currency).

5.21 Securitisation can play a significant role in diversifying the funding opportunities in Sierra Leone. However securitisation needs a more developed financial infrastructure than the country has at present. Proper sequencing would allow securitisation to realise its full potential when implemented in the future. For example, greater formalisation of the remittance flows, reducing dollarisation, implementation of effective systems for tracking of payment orders (including for anti money laundering), other bond issuances (preferably from the sovereign but could also be from a corporation) that set the benchmark for risk and many others are of more pressing need than securitisation. Clearly some of the above can be done concurrently but some of the above milestones should be reached before a remittance securitisation is embarked upon. Premature entry into international financial markets could jeopardise the financial stability of Sierra Leone and offer facilities for illegal economic activity and money laundering. In the present situation, it could expose the Sierra Leone financial system to credit risks in other countries (IMF 2009). Moreover, the possibility of portfolio investment in Sierra Leone may change the financial behaviour of the Diaspora, causing the largest remittances to be transferred through a portfolio investment channel, rather than the remittances channel. Since securitisation involves the holding of foreign exchange off-shore, a switch into the portfolio investment channel would reduce the foreign exchange within the formal banking system of Sierra Leone.

6. Bringing foreign currency back into formal banking

6.1 Despite a low level of foreign borrowing, the ability of the Government of Sierra Leone to undertake foreign borrowing for infrastructure and public utility repair and re-equipment is constrained by the prospect of currency depreciation (see 9 below) and the limited foreign currency reserves of the Bank of Sierra Leone. We therefore recommend that public utilities in Sierra Leone should issue Exchange Rate Linked Bonds (ERLBs) through approved issuers in the US and the UK. These bonds would be payable in relatively small amounts, say US$100 per bond, but the interest, say at a rate of 5%, and principal repayment would be made in Leones and increase in line with the depreciation of the Leone against the US$. Interest and principal would be payable to a nominated beneficiary in Sierra Leone. We would recommend that the bonds have a maturity of five to eight years. This would allow the issuing utility company to refinance this borrowing by placing longer-term bonds through the Sierra Leone Stock Exchange. We further recommend that beneficiaries of such bonds should be allowed to obtain early repayment at a discount of, say, 10% through selling the bonds to the National Social Security and Investment Trust, for which the bonds would be a good and relatively liquid asset.

6.2 ERLBs would therefore provide a cheap way of providing a regular income and payment to the beneficiary as an alternative to occasional remittances. The issuing public utility company would have the benefit of borrowing foreign currency, while making repayments in the currency in which that utility receives income at a considerable saving relative to current Leone interest rates of around 14%.

6.3 We recommend that Sierra Leone citizens living abroad should be allowed to open non-residents accounts in foreign currencies with approved banks in Sierra Leone, with interest at a rate lower than that payable on ERLBs. This would encourage Sierra Leone citizens to hold their foreign currency savings in the formal banking system in the country.

6.4 We recommend the establishment of registered terminating credit societies to undertake house building or pay school fees, based on the traditional *osusu* system. Citizens of Sierra Leone resident abroad should be allowed to make payments into such societies. A terminating credit society for home building would take regular subscriptions from their members which they would pool to build first one house, and then another, until all the members have been housed. The members would agree the order in which their respective houses would be built. On completion of the building, the credit society would be terminated. This system has the advantage that houses may be built more quickly by such pooling of savings than may be built by individual households building on their own. A similar system could be used to pay children's school fees, with parents contributing to such a society when a child is born, but benefitting from payment of fees only when that child goes to school.

6.5 Membership of such societies by foreign residents would require registration and audit of society activities in order to avoid defrauding well-meaning Sierra Leone exiles who would not be in a position to monitor the activities of societies to which they may contribute. Termination on completion of the financing of the housing or school fees need of members would help to prevent such credit arrangements from developing into pyramid banking schemes.

6.6 To assist in the financing of infrastructure improvement and the reconstruction and repair of social services such as education and health, the Government should issue Diaspora Bonds in amounts of say US$100 each. These would also have a maturity of, say, 5-8 years. Interest on Diaspora Bonds, at a rate of say 5%, would be rolled up and repaid with principal on maturity of the bonds. Interest and principal would be paid in US dollars. We would recommend that matching loans be provided by the International Finance Corporation of the World Bank and multilateral financing agencies.

6.7 Diaspora Bonds, like the Exchange Rate Linked Bonds would help to drain the dollars from the informal banking system, by providing holders of those dollars with remunerative alternative dollar assets or, in the case of ERLBs, assets equivalent to dollar assets. The repayments on maturity of the Diaspora Bonds would therefore come out of dollars brought into the formal banking system by these means. In effect this would securitise the flow of dollars from the informal banking system into the formal banking one. This would be a low risk strategy (depending obviously on the proportion of the dollar proceeds of the Diaspora Bond issue that is spent on imported equipment): If the take-up of Diaspora Bonds is small, then it will bring in relatively few dollars from which to repay principal and interest; but then principal and interest payable would be correspondingly modest.

7. ‘Milestones’ for monitoring financial development

7.1 Diaspora Bonds and ERLBs are predicated on some degree of financial development, in that they would be redeemed out of the concentration of US dollars in the formal banking system, or refinanced by the issue of long-term bonds on the Sierra Leone Stock Exchange. It is necessary to avoid a situation in which such refinancing cannot happen because the formal financial system has failed to develop. Such a failure would expose the issuers of Diaspora Bonds and ERLBs to potentially large repayment liabilities with limited financial means to undertake such repayments. We therefore recommend the monitoring of financial development by regular checking of indicators showing that the financial system is developing and acquiring the liquidity that would allow such refinancing. Those indicators would then provide systematic evidence in support of eventual securitisation and foreign bond issuance by commercial banks and the Government of Sierra Leone. ‘Milestone’ in the form of target levels of attainment for these indicators could then be established.

7.2 We would recommend monitoring and establishing ‘milestones’ with the following indicators:

- Runs of data showing the geographic origin of remittances, by amount and currency;
- Target levels of foreign currency deposits in licensed deposit-taking institutions;
- Improved data on foreign trade receipts and outflows (naturally arising with formalisation of foreign trade);
- Number of households with a bank account compared to that number before the civil war;
- The Ministry of Finance and Economic Development should study the possibility of sovereign bond issuance in U.S. dollars. This would be not so much to raise money as to establish a benchmark credit rating to facilitate future securitisation by commercial banks in Sierra Leone;
- A target should be set to reduce diamond-smuggling, as part of the Kimberley Process;
- The successful refinancing of ERLBs with domestic bonds issued on the Sierra Leone Stock Exchange would be a clear ‘milestone’ in financial development;

7.3 Stronger foreign donor commitments for stable foreign exchange flow. Despite the obvious benefits of conditionality for governance and monitoring purposes, conditional aid makes for less stable foreign aid inflows. One of the purposes of institution-building in Sierra Leone should be the establishment of more reliable and transparent organisations effectively implementing aid programmes. This should give foreign aid donors greater confidence the effectiveness of their assistance, and therefore a greater willingness to enter into less conditional lending. The more reliable inflow of foreign exchange resulting from this would facilitate the securitisation of foreign aid inflows alongside remittances. Bunching up remittances with foreign aid inflows would give better terms for eventual securitisation.

7.4 ‘Milestones’ achieved would lead to an evaluation for next stage of financial construction namely local bond issuance, and securitising remittance flows in a more effective financial system with a stable history.

8. Financial regulation

8.1 The economic experience has shown that the relation between formal and informal foreign exchange markets in a country is complex and contains specific institutional characteristics. However, regulatory and financial instruments exist that can effectively bring foreign exchange back into formal market. Those measures operate on the functional relationship between the liquidity in the illegal foreign currency market and the liquidity in domestic currency. An important consideration is the confidence of the public (households and firms) in the domestic banking system. The inability of their clients to be able to withdraw money from their accounts during the civil war damaged the reputation of Sierre Leone's. The restoration of full confidence in the efficiency and effectiveness of bank payment systems is crucial to bring foreign exchange back into the formal banking system.

8.2 Despite the formal status of the Leone as legal tender in Sierra Leone, the economy has been highly shaped by dollarization where many financial contracts such as mortgages have taken informally the US dollar as reference. In order to bring back the remittances flows to the banking system and channelling them to development purposes is necessary to deal with dollarization.

8.3 From time to time an exchange rate' differential between official and illegal foreign exchange markets has emerged in which the exchange rate in the informal market is higher than in the formal one. This offers scope for arbitrage operations between these markets. Since Leones are necessary to perform domestic transactions, there is a demand and supply relationship between foreign currency and domestic currency in the informal foreign exchange market. The counterpart of the dollars in circulation through informal market is a high volume of domestic currency notes in circulation in the economy.

8.4 In Sierra Leone, there is no maximum limit for the withdrawal of Leones from both current and savings accounts. However, there is a minimum limit below which one cannot withdraw from a savings account. This varies with the respective banks. For purpose of currency in circulation, the most important is the limit on current account. In order to limit the liquidity in the informal market, a maximum limit for the withdrawal of Leones in current and saving accounts should be set. The initial limit should be of 25 millions Leones ($7,000) per account in the first 90 days when a lower limit will be established according to initial outcomes. In addition, it is recommended to establish a ceiling on the nominal value of negotiable cheques of 25 million Leones. These are the amounts that trigger the reporting by commercial banks of suspicious transactions to the Bank of Sierra Leone.

8.5 Those measures will assist in suppressing the informal foreign exchange market by squeezing the liquidity of high value transactions in domestic currency in the system. The shortage of liquidity will cause the exchange rate in this informal market to appreciate. In doing so the exchange rates' differential between informal and formal foreign exchange markets will diminish, consequently encouraging the foreign exchange flows including the migrants' remittances flows to return to the official banking system. These measures to address the liquidity in the informal market are connected to the proposal to legalise the foreign exchange bureaus in 8.8 below. Moreover, those measures would help to suppress money laundering by constraining the cash transactions and by raising the transparency in large commercial transactions through cheques. They would squeeze the cash flows in the illegal diamond market, that largely go through the informal channel. According to our interviews, this market would represent between 15 and 20% of the informal market.

8.6 We recommend that the present threshold limit of money for reporting individual bank transactions is reduced from $10,000 to $7,000. The present limit is widely used around the world, and is obviously appropriate for international transactions. However it is too high for Sierra Leone given the very low average *per capita* income, at around $300, of the population (World Bank 2009), and the need to squeeze informal foreign currency transactions.

8.7 The main point of illegal entry of remittances in the country is through foreign exchange bureaux. According to our interviews, the bureaux are the main suppliers of dollars in the Sierra Leone foreign exchange market. The bureaux are licensed to make foreign exchange transactions in the spot market, that is to buy and sell foreign currencies, but may not make remittances flows. However, it was pointed out to us that the foreign exchange bureaux do a considerable amount of remittance business which they can do efficiently because they are less bureaucratic and faster than banks and the costs of money transfer are lower than in the banking system. It was also reported that they even offer a range of financial services such as health insurance and even banking services such as loans to small and medium-sized companies and possibly even real estate finance. In practice, therefore foreign exchange bureaux have been acting like banks in the provision of a wide range of banking services, loans, clearing, foreign payments and so on, to the business and household sector in Sierra Leone.

8.8 We recommend that the present illegal foreign exchange transactions made by foreign exchange bureaux are legalised but that the bureaux are also integrated into the banking system in order to direct the foreign exchange generated by remittances flows for development purposes. This integration would increase the predictability and sustainability of remittances, making them more effective backing for future securitisation. The bureaux should be encouraged to become a type of special banking branches in which they would provide financial services on behalf of banks. Initially, the banking integration of the bureaux would deal only with foreign exchange transactions in which they would be obliged to deposit in the banks the foreign exchange flows by denominating them by their origins. This could be extended by the offer of banking services through bureaux. We emphasise that the offer of banking services by the bureaux is already happening. The aim of this recommendation is to bring back the remittances flows and current informal banking into formal channels.

8.9 Foreign exchange bureaux offering banking services should obviously be required to have capital requirements defined by the Bank of Sierra Leone. Initially at least, a very low capital requirement is recommended in order to give the bureaux an incentives to legitimate their banking activities and in order not to impose excessive costs on their customers.

8.10 A smooth transition from a heavily illegal foreign exchange market structure to a formal foreign exchange market structure, relies on the present links of the bureaux to the banking system. We are informed that the bureaux hold current account with banks and that the bureaux owners have their own separate accounts. Those owners accounts are the only foreign exchange banking accounts where it is only possible to make deposits in foreign currency and withdraw in Leones. This is therefore the conduit between illegal foreign exchange flows coming from bureaux into foreign exchange accounts held at commercial banks. As consequence of these accounts, the foreign currency banking liabilities have increased in recent years. At moment, those liabilities are bank deposits, suggesting that illegal remittances into Sierra Leone are eventually finding their way into the banking system in the form of deposits. It is not possible to identify the source of all the illegal foreign exchange flows through foreign exchange bureaux. But once the foreign exchange bureaus are licensed as special banking branches, some of those banking deposits will be denominated in the banks' balance sheet as remittances accounts with a longer maturity than demand deposits. We assume that a large part of those flows comes from migrants' remittances. Following the launch of the domestic inter-bank money market in May 2009, banks hold a large amount of money market instruments (Treasuries bills with maturities up to 364 days). The increase in banking deposits in remittances accounts, with a more long-term maturity than demand deposits, would allow domestic banks to hold more assets with a longer-term maturity. This banking profile is fundamental to the process of channelling remittances flows to productive investments.

8.11 Another argument in favour of transforming foreign exchange bureaux into special banking branches is the well known fact that the banking system has very little incentive to open branches in areas with low profitability, mainly in rural areas. Allowing foreign exchange bureaux to operate as special banking branches would help to overcome this problem.

8.12 It has been reported that tax avoidance is a key motivation for merchants to operate in the informal market in foreign exchange because taxes on imports and exports are avoided through informal system. However, the legalisation of foreign exchange bureaus as special banking branches would give merchants access to credit lines and more financial services. This, together with a light taxation regime on the tradable sector, could raise the volume of tradable goods as well as extending the tax base.

8.13 As noted above (see 3.3) remittances are also sent by mobile phone transfers. The mobile telephone company Zain is putting forward a money transfer service Zap. The money exchange is through mobile handset. The mobile company will have a consolidated banking account on behalf of their customers. So the company will be the counterpart against the banking system. The system will be integrated through Western Union. The main advantages are lower cost and access to the unbanked people. This service is already available in other African countries such as Kenya and Tanzania ('Zaine's Tito Alai etc.' 2009). Banks will be responsible for informing the central bank of the remittances through mobile transfer. This will improve data on remittances flows.

8.14 The expansion of those services requires only the increase of mobile companies' stores instead of banking branches. The size of mobile market is of 1.3 millions while the Sierra Leone population is about 6 million people. This mobile service can compete with foreign exchange bureaux in providing financial services, including the illegal remittances. This competition will increase the incentives for the bureaux to legalise their services.

9. Exchange Rate and interest rate projections

9.1 The strategy outlined above is based on certain assumptions concerning the exchange and the pattern of interest rates in the US and UK relative to emerging markets. These are of crucial importance because they affect the value or cost of the securities whose issue is recommended in sections 6 & 7 above. For long time periods neither predictions nor projections are possible with any degree of confidence. The alternative approach is to specify scenarios that can be justified in the context of Sierra Leone as reasonable. External flows in and out of Sierra Leone are almost all in one of three currencies, the US dollar, UK pound, or the Euro. The scenarios include all three.

9.2 This report presents three scenarios for 2010-2020. <u>In the first scenario</u>, the trends in the nominal exchange rate during 2001-2008 are extended to 2020. This is interpreted as the baseline scenario in the sense of representing the smallest probable nominal depreciation. This judgement is reached because with its large trade gap and the unlikelihood of increase external assistance, pressure on the exchange rate can be expected to continue for the foreseeable future. The trends were calculated separately for each currency, which implies that the dollar would weaken against both the Euro and the pound. The trends were calculated on quarterly data. Quarterly adjustment was not statistically significant. To avoid distortions arising from the international crisis of 2008-2009 a dummy variable was applied to these quarters, which showed a high level of significance.

9.3 <u>In the second scenario</u> it is assumed that the government makes the policy decision to maintain a fixed real exchange rate with respect to the external price level. This might be interpreted as maintaining relative purchasing power parity. The Difference between changes the domestic price and external price levels is assumed to be five percent, and the import share is a constant one-third of GDP. The latter determines the 'pass-through' of the devaluation to the domestic price level, which feeds back to require further devaluation. The five percent inflation differential implies than a constant real exchange rate requires a devaluation of 7.5 percent. The exchange rates between the Euro, pound and dollar are assumed constant at the 2009 rate.

9.4 <u>In the third scenario</u> it is assumed that the government seeks to reduce the trade gap to the level of sustained foreign investment and development assistance flows by 2020. The initial gap is seventeen percent of GDP and the target is eight percent (ODA five, FDI three). The import share and the export share are both assumed to have an elasticity with respect to the real exchange rate of unit. The real exchange rate in this case is with respect to trading partners for exports (the assumed difference in price changes with trading rivals is zero), and the external price level for imports (measured as in scenario 2). By using shares the calculations are independent of the rate of growth of the economy. This is the most speculative scenario. The exchange rates between the Euro, pound and dollar are assumed constant at the 2009 rate.

Figure 1: Index of Nominal Exchange Rates for the Leone, Quarterly Data 2001-2009 (2nd quarter of 2004 =100)

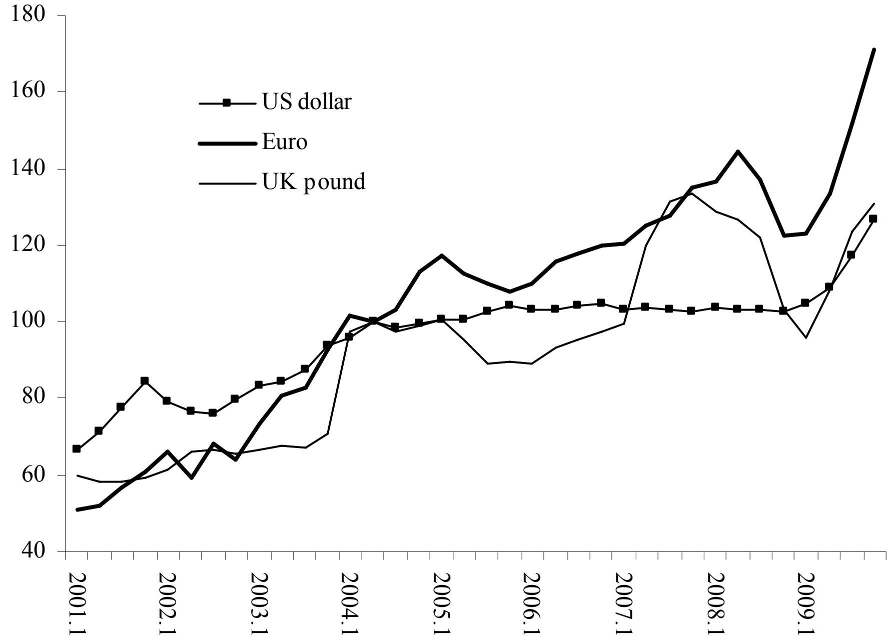

Table 1: Summary of Exchange Rate Scenarios

Scenarios:	Summary
1. Trends, 2001-2009	Log-linear trend from quarterly data, annualised; dummy variable for 2008 and 2009
2. Constant real exchange rate, purchasing power parity CRX(PPP)	The real exchange rate assumed constant; difference between changes in domestic and international prices assumed to be +5 percent per annum; import coefficient of one-third of GDP
3. Depreciating real exchange rate for export competitiveness DRX(Xpts)	The real exchange rate depreciates each year to achieve a trade gap in GDP of five percent in 2020; domestic inflation rate same as for export competitors; elasticity of export share and import share with respect to real exchange rate is unity; initial trade gap is 17 percent of GDP

Table 2a: Nominal Exchange rate scenarios, US dollar

Year	Trends	CRX(PPP)	DRX(Xpts)
2009	3252	3252	3252
2010	3441	3495	3629
2011	3641	3758	4047
2012	3852	4040	4516
2013	4075	4343	5038
2014	4311	4669	5622
2015	4562	5019	6272
2016	4826	5396	6998
2017	5106	5801	7806
2018	5402	6236	8710
2019	5716	6704	9718
2020	6047	7207	10841

Table 2b: Nominal Exchange rate scenarios, Euro

Year	Trends	CRX(PPP)	DRX(Xpts)
2009	4485	4485	4485
2010	5136	4819	5005
2011	5883	5182	5580
2012	6738	5571	6226
2013	7717	5989	6946
2014	8838	6438	7753
2015	10123	6921	8649
2016	11594	7441	9650
2017	13279	7999	10763
2018	15208	8599	12010
2019	17418	9245	13401
2020	19950	9938	14948

Note: For CRXX(PPP) and DRX (Xpts) Euro exchange rate to dollar constant at 2009 average.

Table 2c: Nominal Exchange rate scenarios, UK pound

Year	Trends	CRX(PPP)	DRX(Xpts)
2009	5152	5152	5152
2010	5763	5536	5749
2011	6446	5953	6410
2012	7211	6400	7153
2013	8066	6880	7980
2014	9023	7396	8906
2015	10093	7951	9936
2016	11290	8548	11086
2017	12629	9189	12365
2018	14127	9879	13798
2019	15802	10620	15395
2020	17676	11417	17173

Note: For CRXX(PPP) and DRX (Xpts) UK pound exchange rate to dollar constant at 2009 average.

9.5 With regard to interest rates, we would expect such rates in the US and the UK to remain low for at least up to 2015, with interest rates in key emerging markets such as Brazil and South Korea maintaining significant margins above US and UK interest rates. This may suggest the possibility of attracting foreign currency deposits to Sierra Leone by offering higher interest rates on dollar deposits held in Sierra Leone banks. While this may have some limited effectiveness in drawing foreign currency out of the informal banking system and into the formal banking system, we believe that it would not be possible to manage this transfer effectively if the interest rates on foreign currency deposits are determined by the need to manage potentially much larger bank capital inflows from abroad. A policy of offering higher interest rates on dollar deposits, without the measures put forward in sections 6, 7 and 8 above, would reinforce dollarization and the functioning of the formal banking system as the holder of foreign currency reserves for the informal banking system.

10. Capability Development

10.1 We were very impressed by the professionalism and expertise of banking staff who we met at the Bank of Sierra Leone and Rokel Commercial Bank (see Appendix B). We recognise that they face unprecedented banking problems that, if not quite unique, are common only to a handful of countries that have experienced the collapse of their banking infrastructure and the growing dollarization of the economy. With banking and monetary innovation it is unlikely that a constant level of expertise in dealing with these problems could be maintained in the Bank of Sierra Leone. Nor indeed should it be necessary as credit and monetary arrangements are stabilised and normalised. However, it would be desirable for central banks in Africa, Asia and Latin America to have a forum in which they could exchange experiences of dealing with problems of banking reconstruction and dollarization. The existing assessments of financial systems conducted by the International Monetary Fund are very much driven by the IMF's policy agenda and need to be complemented by arrangements that would give the Bank of Sierra Leone more immediate access to policy, learning and experience, that other central banks may have. This would enhance the capability of the Bank of Sierra Leone to assess and compile its own strategies for financial development.

11. Conclusion and Recommendations

11.1 Remittances constitute an important source of foreign currency inflow into the Sierra Leone economy. This report identifies the methods by which remittances are sent to Sierra Leone, namely through money transfer operators, such as Money Gram and Western Union. However, these remittances account only for a minority of the remittance transfers into the country. A small proportion of the remainder is transferred by mobile phone credits, and the bulk of the remainder enters the economy through unofficial remittance agents operating on behalf of merchants in the country.

11.2 The key issue arising out of these remittance flows lies in the foreign exchange component of remittances sent through informal channels. That component of informal remittances is either held outside Sierra Leone or acts as a cash reserve for informal banking in the country. This promotes dollarization and reduces the effectiveness of formal banking and the monetary policy conducted by the Bank of Sierra Leone. Moreover foreign exchange held abroad or in the informal banking system may not be used as security for the issuance of foreign exchange obligations (securitisation) that could finance the reconstruction and economic development of Sierra Leone. More generally, there are reasons to believe that the inflow of remittances into Sierra Leone may be less stable and may even decline in the future. This consideration makes it even more urgent to mobilise informal remittances through the formal banking system, so that informal remittances do not become another lost opportunity for Sierra Leone.

11.3 This report therefore recommends the following measures to extend the range of remittance facilities available to citizens of Sierra Leone resident abroad; to draw foreign currency back into the formal banking system; to mobilise the foreign currency component of remittances for reconstruction and development; to improve financial reporting; and to regulate informal remittance agencies. We emphasise that **these recommendations do not reduce the right of the senders of remittances to determine the amounts and beneficiaries of remittances. Nor do these proposals limit in any way the right of beneficiaries to determine the legal purposes to which they may choose, or agree with the sender, to devote their remittances.** These proposals are designed to combat fraud and money-laundering by increasing the transparency and reporting of remittances and to mobilise the foreign exchange component of remittances for reconstruction and developmental purposes.

a) Reduced limits on individual bank transactions to restrict the flow of cash into the informal banking system.
b) The extension of foreign exchange bureau licences to allow such bureaux to receive remittances subject to a modest minimum capital requirement, a requirement to report total transfers received or sent as well as individual transfers in excess of US$10,000, or transfers to or from countries 'blacklisted' by the Financial Action Task Force. However, the licence extension should not extend to deposit-taking or making loans, which bureaux would continue to refer to licensed banks.
c) Public utility companies in Sierra Leone should offer for sale, through approved issuing banks in the UK and US, **Exchange Rate Linked Bonds** (ERLBs), in accordance with the securities legislation of the UK and the US respectively. These would be payable in relatively small amounts, say US$100 per bond. Interest, at a rate of, say, 5%, and principal would be payable in Leones to a nominated beneficiary in Sierra Leone over a period of five to eight years. Interest and principal would increase in proportion to changes in the exchange rate between the Leone and the US$, so that the bonds would keep their effective dollar value. The maturity period should allow the issuing utility company to refinance ERLBs by placing longer term bonds on the Sierra Leone Stock Exchange. To assure the liquidity of ERLBs, their beneficiaries should be allowed to obtain early repayment of the principal by selling the bonds to the National Social Security and Investment Trust, at a discount of, say, 10%.
d) Citizens of Sierra Leone resident abroad should be allowed to open **non-resident foreign currency bank accounts** in licensed commercial banks in the country. Interest should be payable on these accounts at a rate slightly below the rate offered on ERLBs.
e) **Terminating credit societies**, based on the traditional *osusu* system, to finance house-building or school fees, should be established with the possibility of receiving contributions from Sierra Leone citizens living abroad. These should be registered and audited to prevent fraud.

f) To finance infrastructure repair and improvement and social services such as education and health, the Government of Sierra Leone should issue **Diaspora Bonds** in amounts of, say US$100 each. These would have a maturity of between five and eight years and pay interest at a rate of, say, five per cent. Interest would be rolled up and paid together with principal in dollars on maturity. We recommend that matching loans be provided the World Bank and multilateral financing agencies.

g) Eventual issue of foreign currency securities backed by the foreign exchange components of remittances and donor aid flows. The latter would require greater and longer-term commitments by aid donors.

h) We recommend 'milestones' for financial development to support these new financial instruments, including report of and data on remittances and target levels of foreign currency deposits with commercial banks; households with bank accounts; sovereign bond issuance by the Government of Sierra Leone to establish a benchmark credit rating for future securitisation; reductions in diamond-smuggling; and the successful refinancing of ERLBs on the Sierra Leone Stock Exchange.

i) Finally, we recommend coordination between the Bank of Sierra Leone and other central banks in Africa, Asia and Latin America to share experience and build capability in managing informal banking and remittances.

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Appendix: Meetings in Sierra Leone

Meetings in Freetown

14-23 October 2009

Thursday 15 October

Dr. Michel Sho-Sawyer, Director of Diaspora Affairs, Office of the President.

Mr. Kallay Musa Conteh, Office of Diaspora Affairs, Office of the President.

Mr. Victor K. Cole, Managing Director, Rokel Commercial Bank (SL) Ltd.

Mr. Tamba Seisay, Finance Manager, Rokel Commercial Bank (SL) Ltd.

Friday 16 October

Mr. Phillip S. Amara, Director, Economic Statistics Division, Statistics Sierra Leone.

Mr. Moses L. J. Williams, Director, Demographic & Social Statistics, Statistics Sierra Leone.

Mr. Ahmed Saybom Kanu, Administrative Manager, Statistics Sierra Leone.

Mr. I.K. Lamin, Financial Markets Department, Director, Financial Markets Department, Bank of Sierra Leone.

Hon. Dr. Samura Kamara, Minister of Finance and Economic Development.

Monday 19 October

Hon. Mabinty Daramy, Deputy Minister of Trade and Industry.

Mr. Dan Kaboyo, Head of Marketing and Customer Care, Zain Sierra Leone.

Mr. Serge Pennaneach, IT Manager, Zain Sierra Leone.

Mr. Salieu V. Kamara, Products Manager, Zain Sierra Leone.

Mr. Sambadeen Sesay, Governor of the Bank of Sierra Leone.

Tuesday 20 October

Mr. Juan Costain, Acting Country Manager, World Bank, Sierra Leone.

Chief of Mission, International Office of Migration, Sierra Leone.

Wednesday 21 October

Mr. Amadu Massally, Global Coordinator, Domestic and Expatriate Nationals Investment, Sierra Leone.

Mr. Peter Donelan, Programme Specialist, United Nations Development Programme, Sierra Leone.

Thursday 22 October

Hon. Minkailu Mansaray, Minister of Employment, Labour and Social Security.

Director of Investment Policy, National Social Security and Investment Trust.

Dr. Abass H. Kamara, Director Corporate Resource Management, National Telecommunications Commission, Sierra Leone.

Mr. Musa Nur Kamara, Secretary to the Board, National Telecommunications Commission, Sierra Leone.

Hon. Alhaji Alpha B.S. Kanu, Minister of Mineral Resources and Political Resources, Sierra Leone.

Friday 23 October

Ms. Yeabu M. Kamara, Director of Banking Supervision, Bank of Sierra Leone.

Mr. Tapsiru L. Dainkeh, Deputy Director, Banking Supervision Department, Bank of Sierra Leone.