Sudan's Banking System: Challenges and Opportunities

SUDAN TRANSPARENCY AND POLICY TRACKER

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Acronyms

AEOI	Automatic exchange of information
AML/CFT	Anti-money laundering/ countering of financing of terrorism
AQR	Asset Quality Review
ARB	Animal Re-sources Bank
BNPP	*Bank Nationale de Paris* Paribas SA
CBoS	Central Bank of Sudan
CBR	Correspondent Banking Relationship
CDD	Customer Due Diligence
CIASA	Sudan Credit Information and Scoring Agency
CPI	Corruption Perceptions Index
DFS	Digital Financial Services
DoJ	US Department of Justice
E-15	Government Payment Receipt with Unique Number
EDD	Enhanced Due Diligence
EU	European Union
FATF	Financial Action Task Force
FFC	Forces of Freedom and Change
FIU	Financial Intelligence Unit
FSTF	Financial Stability Task Force
GDP	Gross domestic product
HIPC	Heavily Indebted Poor Countries Initiative
IFI	International Financial Institutions
IMF	International Monetary Fund
LOLR	Lender of Last Resort
MCP	Multiple Currency Practices
MENAFATF	Financial Action Task Force (FATF) for the Middle East and North Africa Region
ML	Money laundering
MoFEP	Ministry of Finance & Economic Planning
MSME	Micro, Small, and Medium Enterprises
NCP	National Congress Party
NPL	None-Preformat Loans
OFAC	Office of Foreign Assets Control

PFM	Public financial management
PEP	politically exposed person
PRSP	Poverty Reduction Strategy
SAF	Sudan Armed Forces
SCEE	Supreme Committee for Economic Emergency
SCP	Strategic Commodity Portfolio
SDR	Special Drawing Right
SFSP	Sudan Family Support Program
SMP	State Monitored Program
SOE	State-Owned Enterprise
SSTL	States Sponsoring Terrorism List
STPT	Sudan Transparency and Policy Tracker
TA	Technical Assistance
TF	Terrorism Finance
TFA	World Trade Organization’s Trade Facilitation Agreement.
TSA	Treasury Single Account
TSC	Transitional Sovereign Council
UDCR	Unified Digital Collateral Registry
VAT	Value Added Taxes
WB	World Bank
WBG	World Bank Group

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1. Abstract

This report examines the performance of the Sudanese banking system. Building on STPT's wartime analysis, "The Banking System During and After the War: Challenges and Policy Recommendations," it offers a comprehensive analysis of the sector, including an overview of recent developments, an assessment of existing challenges and vulnerabilities, and a focus on critical areas such as the supervisory framework, capitalization levels, corporate governance practices, and the prevalence of corruption. The report highlights the mounting challenges faced by banks, including low levels of financial intermediation as measured by credit to GDP ratio, limited innovation in products and services, inadequate adoption of technology, and the breakdown of correspondent banking relationships.

This report evaluates the actions taken by the government of Sudan and the policies implemented by the Central Bank of Sudan (CBoS) during the short-lived first phase of the transition (September 2019-October 2021). It specifically focuses on the measures adopted to reform the banking sector. The report utilizes the implementation status of the recommendations outlined in the Staff Monitored Program (SMP) and Extended Credit Facility (ECF) negotiated between the Sudanese government and the International Monetary Fund (IMF) as a valuable benchmark for assessment.

In the same vein, the report reviews the consequences of the war on Sudan's banking system highlighted in the prior report. Building on this, the paper emphasizes the importance of post-war reforms in rebuilding and revitalizing the banking sector. This involves addressing the damage caused by the conflict, restoring infrastructure, resolving non-performing loans, and ensuring the stability and reliability of the banking system.

The paper also strongly advocates for the implementation of a comprehensive set of banking sector reforms, including some that can be implemented now, during the war, and others intended as a comprehensive reform package to be implemented after the war. These reforms are intended to address the primary vulnerabilities within the sector and enhance its overall performance. By doing so, the banking sector can effectively contribute to inclusive and sustainable development in Sudan.

The recommended reforms encompass various areas, such as strengthening regulatory frameworks, enhancing risk management practices, improving corporate governance standards, developing payment systems and electronic payments, and promoting fintech-enabled financial inclusion. These measures aim to create a more resilient and efficient banking sector that can support economic growth and provide accessible financial services to all segments of society.

There is a need for a well-designed strategy for currency reform, drawing on other national experiences such as in India, Thailand, and Saudi Arabia. It is crucial to look at the optimal currency denomination, banknote exchange, security features, reducing the cost of printing banknotes, and moving forward to new forms of money such as the pilot project for CBDC in order to better manage the informal economy and improve the implementation of monetary policy.

2. Executive Summary

Sudan is suffering from a devastating war, which has already wreaked untold damage and whose final toll remains to be seen. Before the outbreak of the war, the financial sector had already been struggling. The civilian-led government sworn in in September 2019 initiated some positive reforms. But that government was overthrown by a military coup in October 2021, bringing these reforms to a halt. The constitutional crisis that followed for more than a year aggravated the economic crisis and worsened its impact on the population.

Negotiations about the restoration of democracy in early 2023 fell apart, leading to the war. The outbreak of this conflict has had a devastating impact on economic activity, including adversely affecting the banking sector and putting prospects for its reform further out of reach. However, the sector remains critical for the Sudanese economy as a whole and efforts should be made to limit the damage and restore service in the short term. In the longer term, the economic reform initiated by the transitional government should be resumed.

Comprehensive reforms are needed to extract Sudan's banking sector from the inefficiency, corruption, and government interference that have plagued it for decades. This is reflected in the distorting influence of politically exposed people (PEPs) on the sector, high government borrowing, the abuse of the multi-exchange rates system for the benefit of the powerful, and weak regulatory and legal regimes governing the banking and financial sector. These issues crippled the whole economy. Without serious reform of the banking sector, it will be almost impossible to get Sudan's economy back on track.

2.1 Recommendations summary

For the next government to get the economy back on track, it is critical to address banking sector issues as a priority. The recommendations below are intended as longer-term recommendations for when the country exits from war and are considered a companion to the STPT piece on urgent priorities in wartime, "**The Sudanese Banking System during the War: Challenges and Policy Recommendations.**" Banking sector reforms must be carefully designed and executed in phases to avoid the risks that the reform may fail. A broad approach to reform the banking sector is to create a more robust and sound governance framework, reinforcing institutional capacity, and investing in human capital. This would be the appropriate starting point to create a healthy environment for the recovery of the banking sector. In addition, the timeliness, quality, and integrity of data and statistics should be increased, in parallel building a culture of transparency and accountability in the banking sector.

Two decades of economic sanctions isolated the country's financial sector from the global financial community; and further damage was done by the recent military coup and war which led to continued sanctions which cost heavily in lost trade, investment, and international aid. The financial system is small and financial inclusiveness is very low, especially outside of the major urban centers. The financial sector needs to be restructured using international best practices.

Corruption creates risks for global banks engaging in business activities in Sudan, creating a disincentive for them to do so. A country with weak governance, ineffective supervisory institutions, and inadequate anti-money laundering and countering the financing of terrorism (AML/CTF) measures is more exposed to corruption and attracts perpetrators of illicit financial activities. A cash economy lends itself more easily to illicit activities, while these activities blunt the development of the banking sector. Enhancing corporate governance in the banking sector, including strengthening banks' senior management and boards, implementing proper risk management, and increasing transparency will reduce this risk. Some banks need restructuring and recapitalization as well. Applying those measures will create a resilient banking sector and will contribute to reducing corruption. Completing asset quality reviews and finalizing the new banking law will open the door for foreign banks to come to Sudan.

Most importantly, the primary focus for reforming the Sudanese banking sector should involve several key priorities. These include enhancing the independence and supervisory capabilities of the Central Bank of Sudan (CBoS), addressing financial stability risks through the modernization of regulations and guidelines, and continuing to address deficiencies in AML/CFT measures.

To effectively address the challenges, a revised Banking Business Regulation Act that incorporates a comprehensive resolution regime for the banking sector must be enacted, aligning it with international best practices. Measures should be implemented to ensure that banks adhere to corporate governance standards in line with the Basel Committee on Banking Supervision Corporate Governance Principles. This includes addressing issues related to conflict of interest and transactions involving related parties, operationalizing a dual system of conventional and Islamic banking to expand access to credit, and adopting reserve money targeting for enhancing liquidity management operations, where the re-introduction of conventional banking will foster the development of more effective monetary instruments, while intensified efforts to strengthen governance and institutions, and curb corruption, would be critical for sustaining public support for the government and reforms.

2.1.1 General reform measures

1. Secure continuous commitment from the highest levels of CBoS management for banking sector reform.
2. Enhance CBoS independence and capacity to supervise banks and other financial institutions.
3. Terminate CBoS' shareholding in private and public banks it should be overseeing.
4. Designate a single body to lead the intergovernmental coordination for financial integrity and mandate it to reinforce coordination efforts required from multiple institutions including the CBoS, Ministry of Finance & Economic Planning (MoFEP), Bank Unions, private sector, law enforcement agencies, anti-corruption commission, and prosecutorial authorities.
5. Promote a culture of transparency, information sharing, and accountability in the financial sector.
6. Enforce existing laws strictly and reform them to fully meet international standards in adhering to banking regulations and international best practices.

2.1.2 International institutions

1. Assist the government by providing capacity building and technical expertise needed to support its plans to reform the banking sector in Sudan.
2. Provide technical assistance to reform policies and build institutional capacity in areas of need, especially banking supervision and financial intelligence.
3. Assist in the digital transformation in the banking sector and especially in the CBoS and the government to ensure transparency and collection of all necessary information to fight fraud and corruption.
4. Assist the government in eliminating the use of cash and increasing the economic and financial inclusion of its citizens to encourage their active participation in the formal economy.
5. Assist in improving information sharing among jurisdictions through the automatic exchange of information and the systematic registration and disclosure of the beneficial ownership of companies, trusts, and other organizations.
6. Press jurisdictions with financial institutions offering secrecy provisions that attract illicit financial out-flows to take countermeasures to discourage this activity.
7. Assist in promoting the engagement of global correspondent banks with Sudanese banks.
8. Pressure Sudanese banks to apply enhanced due diligence (EDD) measures on transactions involving PEPs and entities formally or informally linked to them.
9. Pressure Sudanese banks to adhere to AML/CFT standards, including EDD and the tracking of high-risk transactions.

2.2 Methodology and approaches

This report assesses the actions of the government of Sudan during the short-lived first phase of the transition (September 2019-October 2021), and the policies of the CBoS to address banking sector reform. In this regard, the status of implementation of the recommendations of the Staff Monitored Program (SMP) negotiated between the government of Sudan and the International Monitory Fund (IMF) proved a useful yardstick. The report also takes account of the repercussions of the April 15, 2023 war on Sudan's banking system, although, as noted above, these are addressed in greater detail in a companion piece, “The Banking System During and After the War: Challenges and Policy Recommendations.” That piece explores the impact of the conflict and provides a set of recommendations to mitigate the effects of the war, enabling the resumption of normal daily banking operations. This piece provides the context for longer-term reform that will need to be undertaken once stability is restored.

In preparing this report, we reviewed existing literature on Sudan's banking sector reform, including official CBoS and MoFEP reports; government plans; the recommendations of international financial institutions (IFIs) for resolving the daunting macroeconomic distortions plaguing the national economy, stabilizing the economy, and laying the foundations for inclusive growth; studies addressing Sudan’s economic reforms and evaluating different governments’ economic performance indicators since 2019 and data related to our subject in the media (articles, workshops, interviews, videos). We interviewed officials, ex-officials, and experts in the banking and financial sector to get their insights on addressing the economy and banking sector challenges.

3. Introduction

Among the key demands of protesters who brought down the three-decade rule of President Omer al-Bashir in April 2019 was the uprooting of pervasive official corruption in the country. The transitional government sworn in in September of that year under the leadership of Prime Minister Abdalla Hamdok began rebuilding democracy in Sudan and reforming its collapsing economy, including taking tentative measures to reform the banking sector. The military coup that overthrew the transitional government in October 2021 halted all efforts to rebuild the economy and democracy in the country. The war has only created further obstacles.

The first transitional government inherited a collapsing economy and ruined the banking sector, which required urgent intervention to uplift it and arrest the decline of the economy. In its short tenure, the transitional government introduced economic reforms that increased hardships for the majority of Sudanese in the short term but were supposed to help stabilize the economy and pave the way for growth. The most painful reforms were the restructuring of the subsidies on fuel and electricity and the managed floating of the Sudanese pound in February 2021 from the fixed rate of SDG 55 to one US dollar to a rate closer to the parallel market's rate, which at that time was SDG 375 to one US dollar and today approaches 800 SDG to one US dollar. Over the 2018-2020 period, the country experienced a growing divergence between the official and parallel exchange rates. It was estimated that 90% of transactions were taking place at the parallel rate.[1] These significant changes factored into the US government's decision in December 2020 to remove Sudan from its list of State Sponsors of Terrorism List (SSTL), ending a process of terminating more than two decades of strict trade and financial embargoes on the country.

These macroeconomic reforms and the resulting changes in its international status opened Sudan for re-engagement with the international financial and banking systems and the global economy. The extension of a US bridge loan to the World Bank in March 2021 cleared Sudan's arrears, allowing the WB to resume financial assistance to Sudan. The changes also removed political obstacles to debt forgiveness under the IMF's Highly Indebted Poor Countries Initiative (HIPC).[2]

Despite the positive changes, Sudan's transitional government struggled with a nearly bankrupt treasury, one of the highest rates of inflation in the world, the legacy of three decades of mismanagement, pervasive official corruption, and ineffective reforms of the banking sector and economy. Not fixing the banking sector will continue to threaten the prospects for economic recovery and risk derailing political stability and security for any new government while undermining institutions and jeopardizing sustainable development and the rule of law.

4. Three decades of a deformed banking sector

The first transitional government, which assumed office in August 2019, inherited significant economic challenges, including a contracting economy, large and growing fiscal deficits, high and rising inflation, and depleted international reserves.[3] In addition, the banking sector displayed egregious structural problems, including weak legal and regulatory frameworks, severe deviations from international standards, and corruption. A well-functioning financial sector is necessary for the growth of the economy and so, reform of the sector is of paramount importance in the reform of the national economy.

[1] Exchange rate reform in Sudan https://www.theigc.org/sites/default/files/2021/10/SDN-20260_Exchange-rate-reform-in-Sudan.pdf

[2] IMF Press Release No. 21/199, "Sudan to Receive Debt Relief Under the HIPC Initiative," June 29, 2021, https://www.imf.org/en/News/Articles/2021/06/29/pr21199-sudan-to-receive-debt-relief-under-the-hipc-initiative

[3] IMF Staff Monitored Program, "Staff Report," October 2020, https://www.imf.org/-/media/Files/Publications/CR/2020/English/1SDNEA2020003.ashx

During three decades of kleptocratic rule under deposed President Omer al-Bashir and the Islamist regime that was the real power behind the throne, senior officials of the ruling National Congress Party (NCP), the Islamist Movement, the executive, and family members and business associates of this expanded ruling class systematically captured the banking sector and main arteries of the national economy for their benefit, to the detriment of the broader economy and the population.

The main challenges that needed urgent tackling in the banking sector as the first transitional government took office included:

1. Pervasive corruption practices across all state institutions are orchestrated by top state authorities.
2. Political influence on Central Bank decision-making, including politically influencing companies and its impact on the banking sector.
3. Weak legal and regulatory frameworks.
4. Corruption, inefficiency, and lack of governance in the banking sector.
5. Corruption in all sectors of the economy and at all levels requires serious reform in many sectors, including the banking sector, taxation, customs, export/import, and other government units.
6. Prevalence of bad debt crises and non-performing loans (NPL) with a serious impact on the financial sector, for example:
    a. The bankruptcy of the Animal Resources Bank (2013-2014).
    b. The collapse of the Real Estate Commercial Bank in 2008.
    c. The Omdurman Bank (ONB) accounted for more than half of NPL and about 28 percent of bank lending in the country in 2008.[4]
7. Excessive borrowing of the former government from the Central Bank.
8. Government ownership of many commercial banks.
9. Failure to integrate Sudanese banks with the international banking system even after the US lifted sanctions on Sudan in 2017.
10. Lack of transparency in export/import activities contributed to draining foreign exchange, reducing domestic resources and trade, creating macroeconomic instability, and worsening poverty and inequality.

Overall, the banking sector remains fragile, with several banks undercapitalized. Reported NPL ratios significantly underestimate the true state of impairment of bank loans, and even with these low reported NPLs twelve banks had capital adequacy ratios below the regulatory 12 percent minimum in December 2018. Large US penalties on international banks in 2014 contributed to a sharp decline in correspondent banking relationships with Sudanese banks. Most importantly, equity injections into several banks resulted in the CBoS owning stakes in 15 of the 37 banks as of 2018, and restructuring has been lagging.

4.1 Corruption in the banking sector

As a carryover from old practices, corruption is well entrenched in the banking sector and is considered one of its biggest challenges, hindering financial development and economic recovery. As a result, citizens' trust in banks is very low, and Sudan's banking services penetration is the lowest in the East Africa region. Corruption also weakens banks, reduces their capacity for investment, and contributes to the economy. It also discourages the private sector from working with banks and encourages an informal economy.

Due to the spread of corruption, de-risking measures are taken by most foreign banks against Sudanese banks, who remain reluctant to engage in financial activities in Sudan which continues to be a "risky" country, despite the delisting from SSTL in December 2020. A recent stress test conducted as

[4] Sudan Tribune, "Sudan denies reports on selling local banks," https://sudantribune.com/article35427/

part of an asset quality review (AQR) of seventeen banks commissioned by the EU mission in Sudan which was finalized in June 2022, proved the banking sector is fragile, and supervisory practices are not enforced.[5] During Bashir's regime, state-owned enterprises (SOEs) were favored in lending by most banks which led to the accumulation of NPL and reduced the availability of credit to the private sector. This practice did not disappear completely after the revolution and remains to be addressed.

Several factors contribute to the entrenchment of corruption, and most have to do with the way the CBoS has failed to exercise its supervisory and enforcement mandates. In the absence of an effective anti-corruption framework and will to enforce CBoS banking regulations, state-owned banks remain under the umbrella of CBoS. Having bailed out several commercial banks that were on the brink of collapse, the CBoS acquired shares in these banks, leading to CBoS staff and former staff members sitting on the boards and senior management of banks that should be under CBoS supervision. The lack of access to banking sector information by the public will continue to create an environment favorable to the entrenchment of corruption.

Major corruption scandals occurred during the Bashir era even as corruption was normalized at the time, with many banks acting in defiance of regulations with impunity and undermining the interests of investors and shareholders. Some of the most egregious cases are given below.

a) <u>The collapse of the banking sector amid the withdrawal of correspondent banking relationships (CBR)</u>[6]

In a "Statement of Facts"[7] submitted to the US Southern District Court of New York, the US Department of Justice (DoJ) charged that in 1997, shortly after the imposition of US sanctions against Sudan, BNP Paribas SA, mostly through its Geneva branch, agreed to become the sole correspondent bank in Europe for Sudanese Government's Bank 1 (believed to be the CBoS), which, the Office of Foreign Assets Control (OFAC) of the US Department of Treasury, in charge of enforcing US sanctions, had designated as a sanctioned entity. Sudanese Government Bank 1 then directed all major commercial banks located in Sudan to use BNPP Geneva as their primary correspondent bank in Europe. As a result, all or nearly all major Sudanese banks had US dollar accounts with BNPP Geneva. In addition to processing US dollar transactions, in 2000, BNPP Geneva also developed business in letters of credit for Sudanese banks. Due to its role in financing Sudan's export of oil, BNPP Geneva took on a central role in Sudan's foreign commerce market.

By 2006, letters of credit managed by BNPP Geneva represented approximately a quarter of all exports and a fifth of all imports for Sudan. Over 90% of these letters of credit were denominated in US dollars. In addition, the deposits of Sudanese Government Bank 1 at BNPP Geneva represented about 50% of Sudan's foreign currency assets during this period.

BNPP Geneva conspired with Sudanese banks and financial institutions outside Sudan to process thousands of US dollar financial transactions for sanctioned entities totaling more than $6 billion, including transactions involving 18 Sudanese-sanctioned entities with a value of approximately $4 billion. The vast majority of these Sudanese transactions involved a financial institution owned by the government of Sudan, despite the government of Sudan's role in supporting international terrorism and committing human rights abuses during this period.[8]

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[5] Sudan First Review under the Staff-Monitored Program, available at https://www.imf.org/en/Publications/CR/Issues/2021/04/21/Sudan-First-Review-Under-the-Staff-Monitored-Program-Press-Release-Staff-Report-and-50176

[6] Unpublished presentation by banking expert, on file with author

[7] U.S. Department of Justice, "Statement of Facts," dated June 28, 2014, available at: https://www.justice.gov/sites/default/files/opa/legacy/2014/06/30/statement-of-facts.pdf

[8] Ibid

Sudanese banks also engaged in illicit financial deals with Commerzbank and Deutsche Bank during Bashir's regime, processing transactions for the importation of raw materials, and other sanctioned commodities in violation of US sanctions. Later, BNP Paribas settled a lawsuit with the US government for the staggering amount of $8.9 billion in forfeitures and fines for violating US sanctions on doing business with Sudan. In 2015, Commerzbank and Deutsche Bank also faced fines for violating US sanctions due to their engagement in foreign trade transactions with some Sudanese banks.

As a result of those heavy fines, most foreign banks stopped dealing with Sudanese banks. This caused big distortions in foreign exchange rates and created a high demand for foreign currency which fueled the black market.

b) The collapse of the Real Estate Commercial Bank in 2008

The government established the Real Estate Sudanese Bank (REB) in 1966 as a public service bank to provide easy loans to public sector workers and other citizens who could not afford to build family homes. By the time the Bashir regime came to power in 1989, the bank had made tens of thousands of loans to its intended limited-income clientele and acquired vast stretches of urban plots as investments.[9]

The collapse of this bank in 2008 offers an example of the collusion between the inner circles of the regime and domestic and foreign investors of suspect backgrounds. It also illustrates how the Bashir regime sold immensely rich public corporations, even if struggling due to their management deficiencies, to its loyalists and regional enablers at steeply discounted prices during its vast privatization drive in the 1990s and early 2000s. Such garage sales served as a means for the capture of state assets for the benefit of the few.

Jumma Ibn Fahad al-Jumma is a financier and investor with a long record of arrests and prosecutions in his native Saudi Arabia where he was jailed for defrauding more than 8,000 investors in his enterprises of more than 1,115 m. ryals.[10] In 2002, Bashir issued a presidential decree abrogating the 1966 law establishing the REB, paving the way for the sale of the bank and part of its assets to Al-Jumma and a regime insider for a reported $15.5 M. The new owners laid off most of the bank's workers, renamed it Real Estate Commercial Bank, and proceeded to sell large stretches of urban plots, ignoring contractual stipulations limiting such sales and conditions requiring the development of the plots.

These violations and other malpractice undermined the position of the bank and forced the intervention of the CBoS as a lender of last resort to salvage it, including by buying back 66.6% of the shares at a cost of $60m.[11] The Real Estate Commercial Bank continues to be problematic. The local media documented the misappropriation of funds in depositors' accounts by bank employees in the bank's branch in Nyala in December 2019.[12]

c) The bankruptcy of the Animal Resources Bank 2013-2014

The Animal Resources Bank was established in 1992 by small shareholders with the encouragement of the state, which contributed 30% of the capital in cash and gave the assets and properties of the

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[9] Elharak Elsiassi, "Presidential raid to rob the Sudanese Real Estate, Alharak exposes the implication of the deposed president in selling a national bank," February 20, 2021, available at: http://alharakalseyasi.com/1406/

[10] Mawatn Alakhbar, "The Saudi judiciary orders the businessman, Jumma Al-Jumma to refund the investments of 8,000 shareholders," July 20, 2011, in Arabic, available at: http://mawtenalakhbar.com/p/279

[11] Elharak Elsiassi, "Presidential raid to rob the Sudanese Real Estate, Alharak exposes the implication of the deposed president in selling a national bank," February 20, 2021, available at: http://alharakalseyasi.com/1406/

[12] Kandaka News, "Sudanese Real Estate Bank: countless violations," December 2, 2019, in Arabic, available at: https://kandakanews.com/177/

Livestock and Meat Marketing Corporation and the Livestock Roads Company to the bank in order to develop this important sector. Based on its specialization, the bank's mandate was to develop the livestock sector in the country and increase livestock exports as a strategic goal for the country so that it would be a real addition to the Sudanese economy and support and development of the traditional sector.

The establishment of the bank was intended to achieve the objectives and recommendations of the comprehensive national strategy conference, which aimed to triple the number of livestock, oversee a 20-fold increase in exports, and develop the traditional sector, which owns 85% of the livestock in Sudan. In April 1992, the Council of Ministers approved the establishment of the bank, and on September 15 of the same year, the founders' conference was held. In April 1993, the Bank of Sudan issued a license to the Animal Resources Bank (Livestock) to practice banking, and it was officially inaugurated on May 18, 1993.

The ARB was one of the banks in Sudan most affected by the sharp deterioration in business following the succession of South Sudan in July 2011. The CBoS intervened to save the bank from bankruptcy, acquiring 55% of its shares.[13] However the bank was plagued by serious financial violations, such as concentration of finance for the chairman's private business, sale of valuable bank assets including livestock and meat markets, infrastructure for livestock, veterinary services centers, roads, trains, railways, property, land, and later bank branches, and prioritization of extending of credit in other sectors, and speculating in construction materials and hard currency (according to Islamic law)[14] completely neglecting the animal resources sector. In 2014, Mr. Mahdi Akrat, a member of the general assembly and parliament, attacked the bank's board chairman and general manager, accusing them of changing the goals of the bank from developing livestock to a commercial business. Akrat mentioned that the bank sold about forty acres of agricultural land in the Halfaya area for 700,000 SDG, however, the buyer transferred the same land to a residential scheme for 400 million SDG million, i.e., more than 570 times its purchase price![15]

An undisclosed source reported the spread of corruption in the bank and its financial struggles to *Al Rakoba* newspaper which led in late 2022 to the layoff of around 120 employees, not including those facing corruption charges.[16] The Chairman of the Bank Shareholders Committee, Mr. Khaled Wafi, issued a statement confirming the "spread of corruption in the bank without any corrective actions from the bank's BoD or the CEO, who does not have sufficient administrative and banking experience to manage the bank and whose appointment was a violation of the Transitional Sovereignty Council Resolution No. 516 and other regulations."[17] Mr. Wafi argued that the bank's employees had their rights violated and were threatened with layoffs, that the funds of shareholders, depositors, and investors were threatened, and this was covered up in clear disregard for professional and ethical controls.[18]

d) Malpractice in the allocation of investments and loans

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13 Sudan Democracy First Group, "Banking System in Sudan: Political Influence and Personal Interests Breed Corruption and Lack of Transparency," December 2018.

14 Zuhair al-Sarraj, "Death Squad,' a Facebook post describing massive corruption in the management of the Livestock Bank that led to the collapse of the bank, in Arabic, March 1, 2020, available at: https://www.facebook.com/Yalanawathiq/posts/524797778165210/

15 "Jamal Al-Wali Bank," Alrakoba https://www.alrakoba.net/1719931/%D8%A8%D9%86%D9%83-%D8%AC%D9%85%D8%A7%D9%84-%D8%A7%D9%84%D9%88%D8%A7%D9%84%D9%8A/

16 "'Excluding employees accused of embezzlement' … the Livestock Bank displaces and dismisses 120 employees and worker," Al Rakoba, December 31, 2022, https://www.alrakoba.net/31792610/

17 "Shareholders of the Livestock Bank give the governor of the Bank of Sudan 72 to dismiss the general manager," Al Sudan Today newspaper https://alsudantoday.com/sudan-news/breaking-news/184559

18 Al Sudan, "Shareholders of the Livestock Bank give the Governor of the Bank of Sudan 72 to dismiss the General Manager," January 23, 2023, available at https://alsudantoday.com/sudan-news/breaking-news/184559

Some banks bend or break rules and regulations on the allocation of loans to favor their relations or for personal gain. As a result, many loans were approved to clients who were not creditworthy, resulting in a large number of defaults. Due to this malpractice, the non-performing loans in the banking sector reached 28% in 2007-2008, which is almost five times the standard set by the Basel Committee for Banking Supervision (6%).[19] The Central Bank was forced to intervene to bail out multiple banks to avoid insolvency.

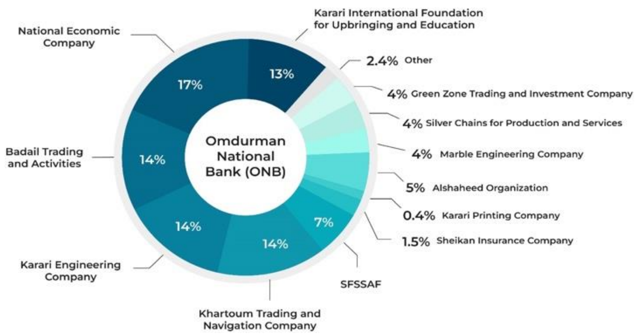
One of the banks that suffered from defaults on loans was Omdurman National Bank (ONB), which was exposed during the period from 2005 to 2009, and faced successive financial crises, which put the bank on the verge of collapse. The CBoS intervened to bail out ONB, which became 85% owned by the Central Bank. In May 2018, the late Governor of the CBoS, Hazim Abdel Qader, issued a decision that the bank would relinquish 53% of its shares (or 45% of the total) in ONB, to Sudanese Armed Forces' (SAF's) private companies. On May 6, 2018, the CBoS and the MoFEP signed a contract to sell 38 million ONB shares for 10 SDG per share to SAF companies and organizations[20] as follows:

1- 14% to Badael Contracting and Construction company.
2- 14% to Khartoum Trading and Navigation Ltd company.
3- 5% to Silver Chains company.
4- 5% to Green Zone company.
5- 4.5% to Marble Engineering Company.
6- 1.50% to the Al-Shaheed Organization.

The contract obliged the MoFEP to pay the CBoS in five equal yearly installments, with the first installment to be paid five years after the contract signature (and the last installment to be paid ten years after signature).

In 2019, immediately after the Sudanese revolution and before the creation of the first civilian-led transitional government, the CBoS transferred about 44% of ONB shares to a group of companies under the umbrella of the Special Fund for Social Security of the Sudanese Armed Forces, the Military Industrialization Authority, and its subsidiaries, which essentially transferred the state's stake in the bank to the SAF. Shares should be sold on the Khartoum Stock Exchange, offered to the market, subject to trading, and sold at the market value, but this transaction took place outside of that process. Now 86.9% of ONB shares are owned by SAF companies.[21]

ONB's Annual report for 2019 summarizes ownership of its shares as follows: [22]



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19 Sudan Tribune, "Sudan denies reports on selling local banks," July 14, 2010, available at https://sudantribune.com/article35427/

20 Al Sudan, "CBOS waived relinquished part of their ONB shares," April 19, 2019, available at https://www.alsudaninews.com/ar/?p=120369

21 C4ads, "Breaking the Bank," 2022, available at https://c4ads.org/wp-content/uploads/2022/07/BreakingtheBank-Report.pdf

22 C4ads, "Breaking the Bank," 2022, available at https://c4ads.org/wp-content/uploads/2022/07/BreakingtheBank-Report.pdf

4.2 The weak framework for AML & CMT

Sudan has adopted several laws to fight money laundering and combat the financing of terrorism including:

1. the Criminal Act of 1991,
2. Sudan's Counter Terrorism Act of 2001,
3. the Money Laundering and Finance of Terrorism (Combating) Act 2014, and
4. the Human Trafficking Act 2014.[23]

However, the environment of rampant official corruption that characterized the governance system under the Bashir regime seriously weakened the efficacy of the legal and regulatory framework in combatting corruption and reducing Sudan's exposure to the risks of money laundering and terrorism financing. The Financial Action Task Force (FATF) in 2010 deemed Sudan a jurisdiction with strategic deficiencies in its AML/CFT regime. Assessments by the FATF regional chapter for the Middle East and North Africa Region (MENAFATF) conducted in 2011 and 2012 outlined several deficiencies in Sudan's AML/CTF regime, including weaknesses in procedures to identify and freeze suspect assets and the lack of an independent and effective financial intelligence unit (FIU). The assessment team acknowledged some progress in addressing the concerns identified by the FATF that eventually led to Sudan's removal from the FATF list in October 2015.[24]

Still, there is ample evidence that the government has not fully implemented its laws since 2015, and in many instances, has ignored them. For example, the Bashir government introduced timid reform measures in 2015 aimed at controlling the government's revenue and expenditure and ensuring transparency in the management of public funds. These included the launch of a Treasury Single Account (TSA) and the digital collection of government revenue and monitoring of its expenditure through Electronic Form 15 (E-15) projects. However, although these anti-graft measures have proven effective elsewhere, including in Nigeria, they were defeated in Sudan because the government exempted security sector entities and other public enterprises from the application of these controls.

4.2.1 Weak corporate governance

Under the broken process of recruitment of senior staff for banks practiced during the Bashir regime, hiring was based on either political affiliation or connections to the National Congress Party or other political figures. A high percentage of bank CEOs were known to be affiliated with the NCP and financial institutions were central in the rise of Sudan's Islamist movement to economic and political power. Banks continue to use such hiring practices. Many banks fail to follow regulations and best practices to nominate their leadership. While CBoS has clear rules and requirements for the selection of bank general managers, it routinely fails to enforce them.

In the same vein, the CBoS has not updated its risk management guidelines. The risk management regulation currently in place, Circular (1/2005) refers to the need for each bank to establish a risk department. Comprehensive risk management guidelines, addressing credit risk, liquidity risk, operational risk, displaced commercial risk (DCR) and profit rate risk are lacking. The corporate governance regulation from 2010 to date has limited guidance on the functioning of boards and it is not aligned with the Corporate Governance Principles for Banks in accordance with the Basel Core

[23] CBoS, "Sudan Efforts on Anti-Money Laundering and Combating the Financing of Terrorism Report," 2018, available at https://cbos.gov.sd/en/content/sudan-efforts-anti-money-laundering-and-combating-financing-terrorism-report

[24] MENAFATF "Mutual Evaluation Report Anti-Money Laundering and Combatting the Financing of Terrorism – Sudan," November 28, 2012, available at https://www.menafatf.org/sites/default/files/MER_Sudan_English.pdf

Principles for Banking Supervision (BCBS) issued in 2015. The absence of such qualitative requirements on governance, processes, procedures, tools, systems, and controls renders the regulations materially inadequate. This is reflected in the weak standards of risk management employed by Sudanese banks, more particularly with respect to credit risk management policy and procedures, financing standards, asset valuation, and information systems.

The legal and regulatory framework is not conducive to effective prudential supervision. The CBoS faces conflicts of interest arising from its ownership of financial institutions, which is exacerbated by the appointment of its senior staff to the boards of these banks. In addition, the appointment process for the governor and deputy governors limits their independence, and therefore ability to exercise the ample powers provided by the CBoS Act. There is a lack of guidance regarding the management of risks, including risks specific to Islamic finance. Prudential supervision is also constrained by limited capacity and resources (including data reporting systems), as well as by a fragmented, compliance-based, and backward-looking approach that does not ensure a thorough understanding of banks' risk profiles. Corrective actions do not seem to be effective as demonstrated by the existence of banks who maintain problematic status for many years.

The CBoS' conflicting mandate undermines the prioritization of financial stability and banking safety. The CBoS objective of "achieving a balanced and economic and social development" in regard to banking can jeopardize its pursuit of banking sector safety, soundness, and financial stability.

Instead of focusing on the soundness of banks and overall financial stability, the CBoS has pursued multiple development objectives, often through direct interventions in the economy, including ownership of financial and non-financial companies. For instance, the CBoS has an ownership interest in three specialized banks (Agriculture Development Bank, Social and Savings Development Bank, and Industrial Development Bank) and in microfinance institutions, which it uses to promote financial inclusion and channel financing to priority sectors. It also owns shares in another 11 banks, mainly as a result of capitalization of liquidity support. This causes conflicts of interest and creates reputational risk for the CBoS, ultimately undermining its ability to enforce prudential standards.

The CBoS initiated an ambitious plan to enhance the legal and governance framework during the transitional period. The IMF and World Bank Group (WBG) worked with the CBoS to update the Banking Business Act and the CBoS Act, including provisions on governance, risk, and compliance functions for banks. Draft laws and regulations were produced, approved by the CBoS Board of Directors and the Ministry of Justice, and submitted to the Council of Ministers on October 10, 2021 for final approval by the Temporary Legislative Council. However, this process was halted in the wake of the October 25 coup, which reversed many of the tentative reforms introduced or planned by the 2019-2021 transitional government, exacerbating problems in the banking sector, with a significant negative impact on lives and livelihoods.

4.3 The current state of Sudanese commercial banks

Sudan currently has 40 commercial and specialized banks with capital and reserves of $420 Million.[25] Twelve banks are either wholly or majority-owned by the government.

The CBoS directly supervises the banking sector, although direct interference by the government and PEPs is normal. Sudan also has eight foreign banks accounting for 22% of total banking assets, while the sector's total assets are estimated to be around $7 billion, which represents 26% of the country's gross domestic product (GDP) as of the end of 2021. Four banks: the Bank of Khartoum (18%),

[25] Central Bank internal source, on file with author.

Omdurman Bank (14%), Faisal Bank (14%), and Agricultural Bank (8%) account for more than 50% of total assets.[26]

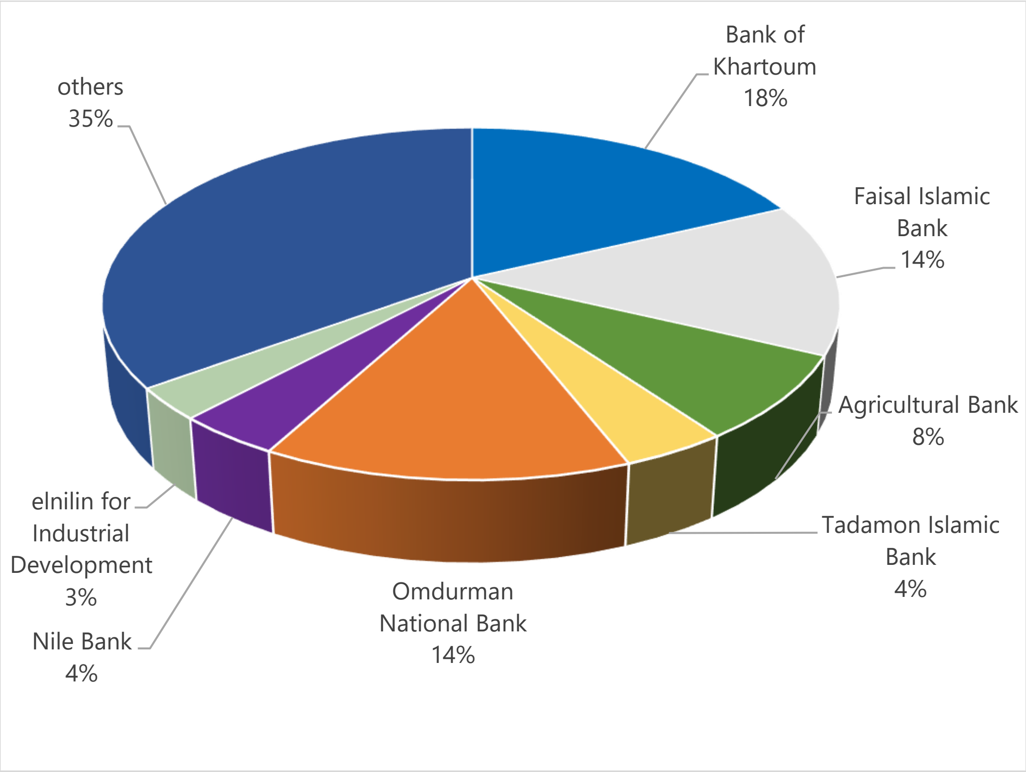
The banking sector is relatively concentrated at the top, but quite fragmented at the bottom. There are 13 banks with less than 1% asset share, and another 12 banks with asset shares between 1-2%. Three of the five fully state-owned banks are among the top 10, while the CBoS has significant stakes in four of the top 10 banks, and four of the fully state-owned banks. The largest bank in the country, Bank of Khartoum (18% asset share), is majority-owned by UAE investors and has no state ownership. Two of the largest five banks have minority foreign ownership (less than 50%) and have no state ownership.

The banking sector is relatively small in relation to the size of the economy. The level of financial intermediation, measured as financing to enterprises (both private and state-owned) and households, has remained stagnant over the past years, reaching 8.7 percent of GDP as of December 2021. Compared to the average of Sub-Saharan Africa (18.8 percent) and lower-middle-income countries (33.1 percent), Sudan lags in terms of financing the real economy.[27]

Preliminary bank stress tests conducted in early 2020 indicated vulnerability to exchange rate depreciation. In March 2020, 10 out of 37 commercial banks (representing more than 40 percent of market share) had short net foreign exchange positions, and five banks' positions were outside the regulatory limit.[28]

The structure and ownership of Sudanese banks

Asset Share of Banks

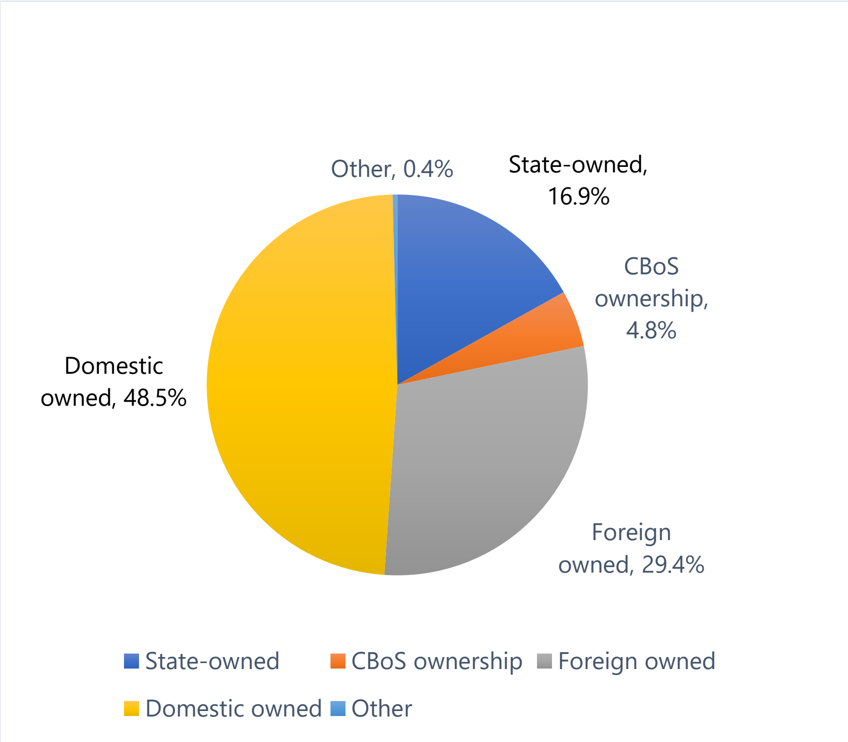


[26] CBOS Yearly Report for 2021 التقرير السنوي للعام 2021 | CBOS

[27] Unpublished presentation by banking expert, on file with author.

[28] IMF Staff Monitored Program, "Staff Report," October 2020, available at https://www.imf.org/-/media/Files/Publications/CR/2020/English/1SDNEA2020003.ashx

Type of Ownership

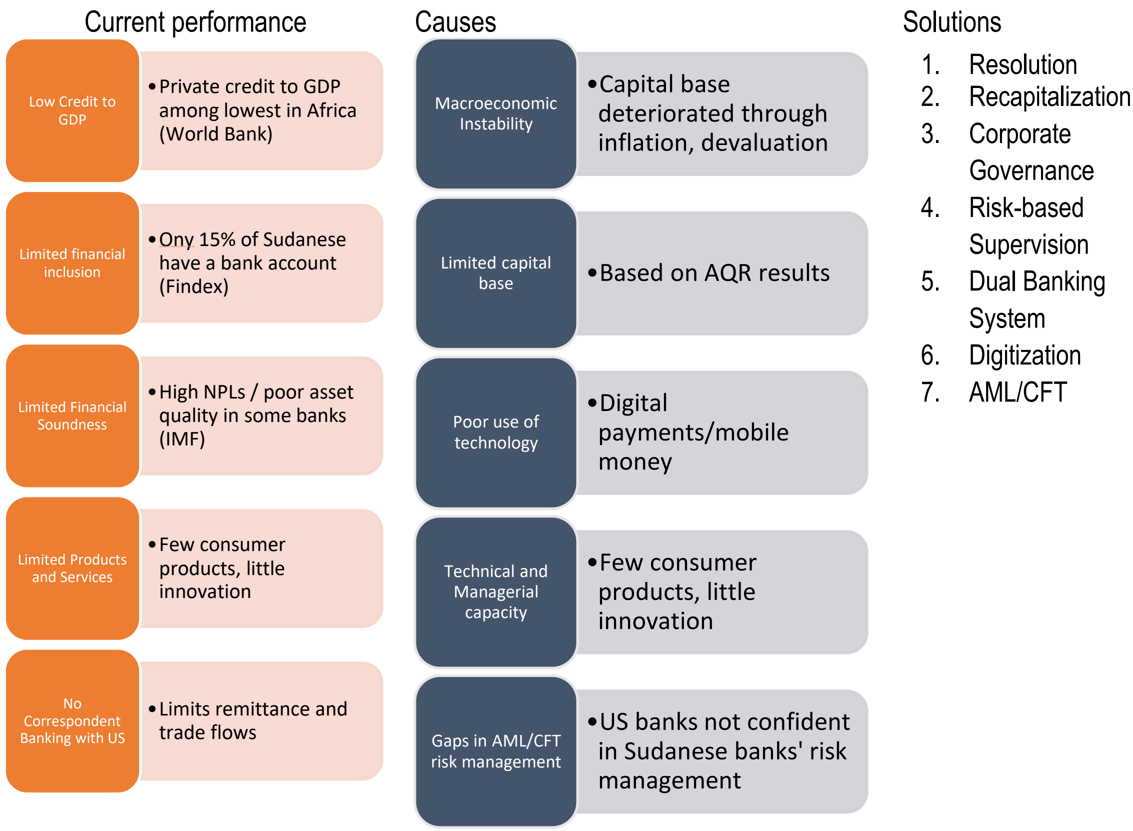


Indicative of the dire state of the banking sector are the results of an asset quality review (AQR) of seventeen banks commissioned by the EU mission in Sudan in 2021 to assess the level of non-performing loans or assets in the sector (NPA). Although the review process came to a halt following the coup, the AQR identified several situations of vulnerability that need to be addressed appropriately to restore the soundness of, and confidence in, the banking sector.[29] Out of 17 banks assessed, only four were identified as not in need of action. Of the remaining 13:

1. Seven banks need simple recapitalization, a process of restructuring the debt-to-equity mixture (with, for example, blockage of dividends for a period of time).
2. Four banks need resolution, a process of comprehensive management, organizational, and financial changes made to improve the financial position of a bank and reduce its losses by making changes in the composition of paid-in capital and organizational structure (unless shareholders recapitalize).
3. Two banks need liquidation (unless shareholders recapitalize).

[29] Unpublished presentation by banking expert, on file with author.

Banking Sector: Current Performance, Causes and Solutions



4.3.1 Sudanese commercial banks' challenges

Financial soundness and vulnerabilities

The banking sector remains vulnerable with several banks undercapitalized. The CBoS sets the minimum capital adequacy ratio (CAR) at 12 percent of risk-weighted assets, but several banks' CARs have been below the requirement for many years, and some CARs are negative. In addition, NPLs are underestimated since the CBoS only defines the past due installments as NPLs rather than the whole loan value. The CBoS borrowed about US$2 billion in foreign exchange from commercial banks years ago but has not been able to repay the loan. These illiquid foreign exchange assets are recorded as excess reserves in the CBoS's balance sheet.

On average, solvency indicators show a banking sector with capital levels below the minimum. The reported CAR for the banking system was 11.0 percent in December 2018 and 7.1 percent in December 2021, below the minimum requirement of 12 percent. However, the average masks important variations at the bank level, with several banks being severely undercapitalized, some having a negative CAR.

It is worth remembering that variation in solvency indicators and capital levels raises questions about the soundness and business model of many banks. In the first place, having several banks with CAR below the minimum (including some with a negative CAR) continuing to operate poses a significant risk to the stability of the banking sector, and reveals the supervisory and regulatory deficiencies that have so far prevented these banks from being resolved or liquidated, particularly considering that many of them have been in this situation for many years. Many of these banks have benefited from CBoS liquidity injections (in the form of investment deposits), which were eventually converted into capital, creating a conflict of interest, given the CBoS's dual role as owner and supervisor.

Foreign currency also has an impact on solvency. From 2016 to February 2021, banking sector vulnerabilities increased considerably as a result of the direct and indirect effects of sharp currency devaluations. This devaluation affected banks' balance sheets directly by devaluing their SDG holdings, but it also generated significant macroeconomic and fiscal pressures. The immediate direct impact of the sequence of currency depreciations over capital ratios of the banking system was severe and devastating, given the magnitude of the devaluation to one-seventh of its prior value. This was transmitted into banks' capital through their foreign currency positions and exacerbated where banks have a relatively low ratio of foreign currency (FX) to total financing. This situation is only likely to deteriorate further in light of the war.

The regulatory and reporting framework for FX risk requires significant improvement to ensure an efficient assessment of risk and timely supervisory reactions. The low frequency and limited granularity of the FX risk-related reports submitted by banks do not provide information sufficient and timely enough to perform an adequate assessment of FX risk at the individual and system levels.

Asset quality has deteriorated considerably since the end of 2017, which is compounded by significant concerns about the relatively low levels of the reported indicators. The NPLs to gross loans ratio increased by from 3.3 percent in 2017 to 3.5 percent in 2021. However, the current levels and growth ratios are rather low for the current macroeconomic and fiscal environment, and for the magnitude of the recent currency depreciation shocks. This raises questions about the real asset quality of banks, as official reported figures do not seem to provide a realistic assessment of nonperforming financing, which suggests that bank capital is also underestimated. The aforementioned AQR assessment gives an indication of the likely true state of affairs.

Financial Soundness Indicators (FSIs) of Banks

Item	2016	2017	2018	2019	2020	2021	Standard R
Capital Adequacy Ratio	18.7%	16.2%	9.9%	15.4%	11%	7.1%	12%
Gross NPLs to Gross Loans	5.2%	3.3%	3.2%	3.5%	3.3%	3.5%	6%
NPLs net of provisions to gross loans	2.1%	0.6%	0.7%	0.7%	1.5%	0.3%	
Loan provision to NPLs	60%	81.3%	72.1%	78.5%	55%	91%	60%-70%
Return on Assets (before tax)	4.7%	3.8%	4.9%	3.5%	3.3%	4.5%	1.25%
ROA (before tax)	46.1%	48%	95%	42.9%	64.2%	74.7%	
Liq. Assets to Total Assets	35.1%	73.3%	51.6%	49.5%	53.7%	67.2%	30%-40%

Source: Central Bank of Sudan

Bank lending is directed largely to wholesale banking business, and evenly spread across the main economic sectors

Lending is the main business model, accounting for more than 40 percent of banks' total assets, but there is quite a lot of variation between banks, ranging from 3.6 percent to 65 percent. Lending to non-financial corporations accounts for more than 60 percent of the total credit, while household lending is less than 20 percent. Lending is quite even across economic sectors, with industry, agriculture, and services each accounting for about 20 percent of total credit. Credit in foreign currency is relatively small, about 7.8 percent of total credit, with one bank accounting for more than 50 percent of the total.

The banking sector operates in line with Islamic law

Since 1984, all banks have been required to operate according to Islamic principles. The CBoS has a Higher Sharia Supervisory Board (established in 1992) that ensures compliance with sharia law, and every other bank is required to have one as well. Commercial banks provide traditional banking services by attracting deposits, granting financing, and holding liquidity in line with Islamic principles. There is a need to adopt a dual banking system, which would allow Western banking as well and this was approved by the transitional government in April 2021.

Payment systems infrastructure

Sudan's payment systems have witnessed a number of developments in the past few years, but still lack a structure to ensure effective participation of all stakeholders. An extensive legal and regulatory framework is in place, but improvements are needed to provide a legal basis for key concepts applicable to payment systems and financial market infrastructure.

Crisis management

The crisis management framework has significant deficiencies and weaknesses that jeopardize the capacity of the CBoS to effectively manage crisis situations, as was evidenced by the response to banknote shortages in February 2018 and to the COVID-19 pandemic in March 2020. The legal framework lacks adequate triggers, there is no clear communication strategy and deficiencies can be found in the internal structure and procedures of the CBoS, the relevant reporting frameworks, and the availability of adequate analytical tools. Moreover, the role of different stakeholders in the overall crisis management framework, including the provision of emergency liquidity assistance, needs to be clarified.

4.3.2 Challenges in implementing monetary and credit policies

Section 6 of the CBoS Act specifies the main responsibilities of the CBoS as follows:

> Achieving stability of prices, maintaining stability of the exchange rate, efficiency of the banking system, and issue of currency of the types thereof, organize, control, and supervise the same.
>
> Formulating and implementing monetary policy, depending in the first place on the market forces in such a way to achieve the national objectives of the national macro economy in consultation with the Minister of Finance and Economic Planning (MoFEP).

However, loose policy guidance has allowed quasi-fiscal activities (QFAs) to proliferate, depriving the CBoS of critical resources, and therefore continuing monetization (i.e., printing additional currency) of fiscal deficits, increasing inflationary pressures.

Banking Finance to the Central Government and Private Sector

With limited external financing, the fiscal deficit has primarily been financed by monetization, fueling a vicious cycle of inflation and exchange rate depreciation. Table 2 shows that the central government's financing from the CBoS has exceeded the stipulated limits set forth in its 2002 (amended in 2012) Act in several ways, including:

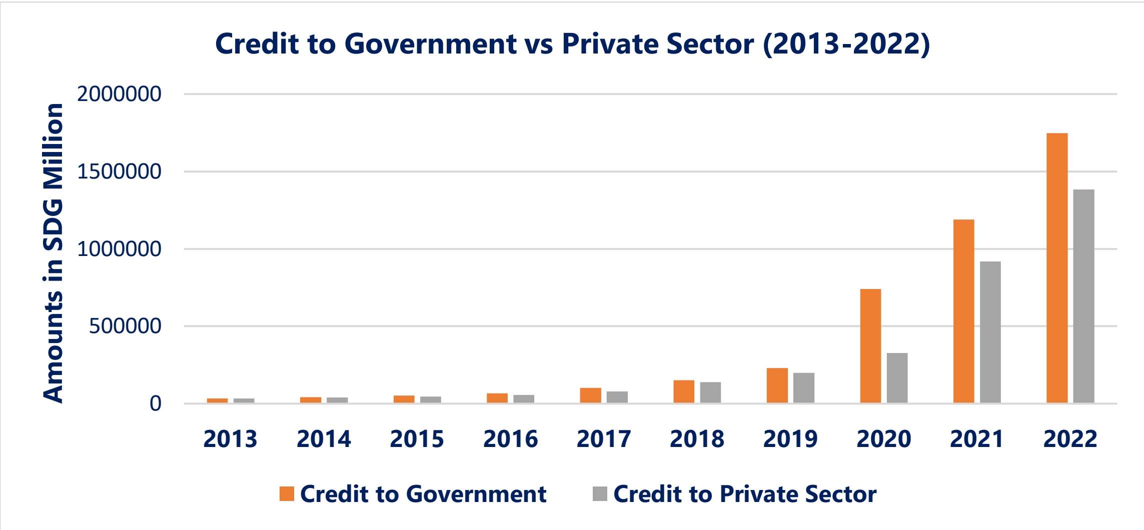
- Temporary advances and issuance of guarantees in both local and foreign currencies for government institutions.
- Financing for the Agricultural Bank.
- Payment of financial obligations to meet the needs of the MOFEP.
- Payment of differentials in gold and wheat prices due to distorting commodity subsidies (prior to the reforms at the end of 2020).

Credit to the Central Government and Credit to the Private Sector

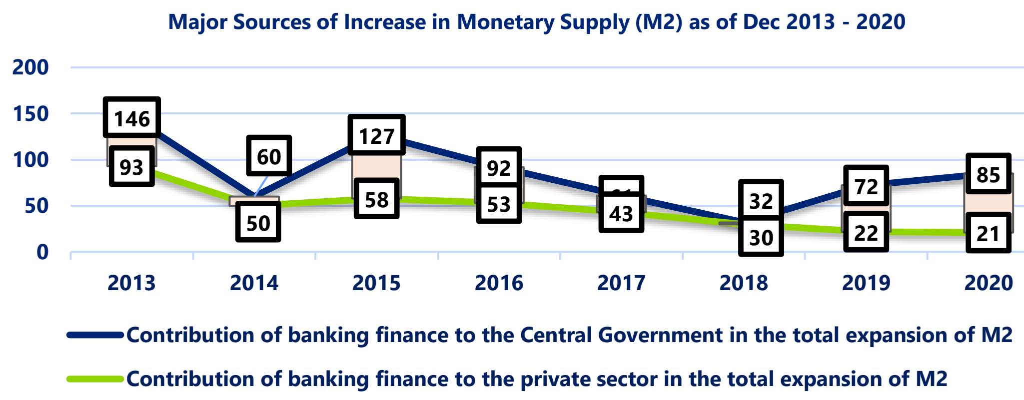
MILLION SDG

Item	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Credit to Government	32,934	40,919	51,195	65,952	100,992	150,487	229,855	740,404	1,189,865	1,747,472
Credit to Private Sector	34,444	39,206	45,555	57,352	79,854	139,116	198,282	327,169	327,169	1,383,292
Total Credit	67,378	80,125	96,750	123,304	180,846	289,603	428,137	1,067,573	2,107,917	3,130,764

Source: Central Bank of Sudan

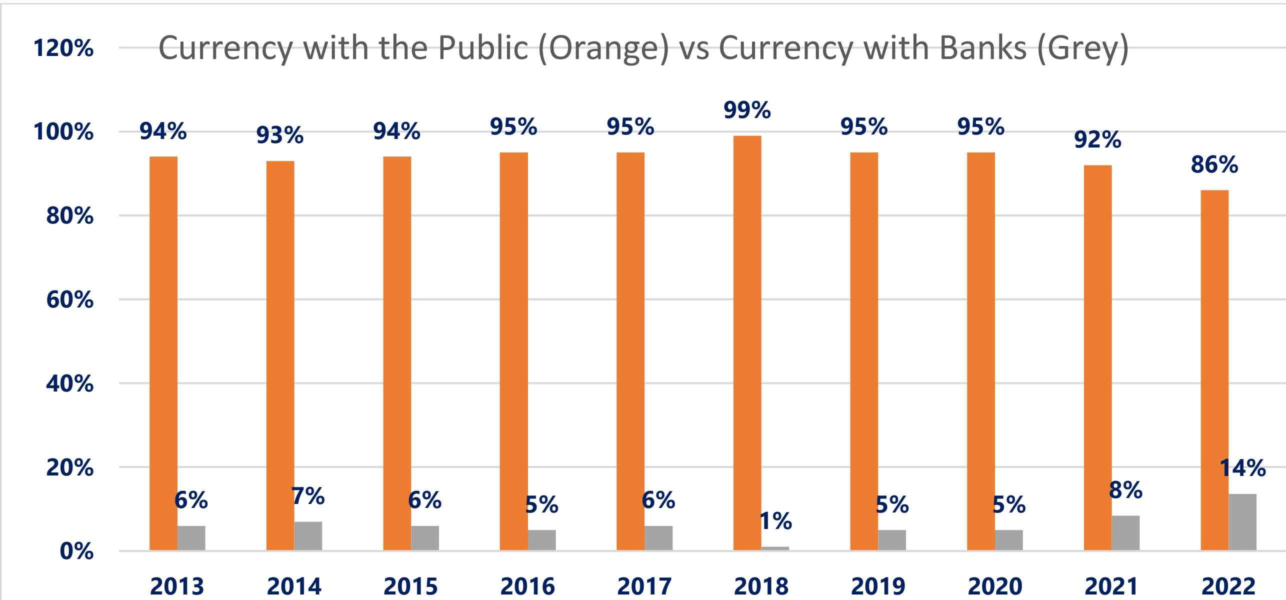


- **Central government crowding out the private sector**
  - The financing of the budget deficit from the CBoS led to excessive expansion of the money supply. This affected the independence of the central bank, and its monetary policy became ineffective as a result of its engagement in QFAs intended to fulfill the requirements of fiscal policy.
  - Financing extended to the central government and public institutions weakened the CBoS' ability to use available monetary policy tools to control the money supply and contain inflation.
  - The figure below shows the contribution of central government financing from the banking system to the expansion of the money supply compared to the contribution of financing extended to the private sector for the expansion of the money supply.



A large quantity of money is outside the banking system

Currency constitutes a large portion of the money supply in the economy because most transactions are carried out on a “cash-and-carry basis”. The money owned by banks collectively constitutes a small percentage of cash in circulation, which limits the effectiveness of monetary policy. This also limits the banks’ ability to create credit facilities for the people in need in the economy and also makes inflation control by the CBoS difficult.



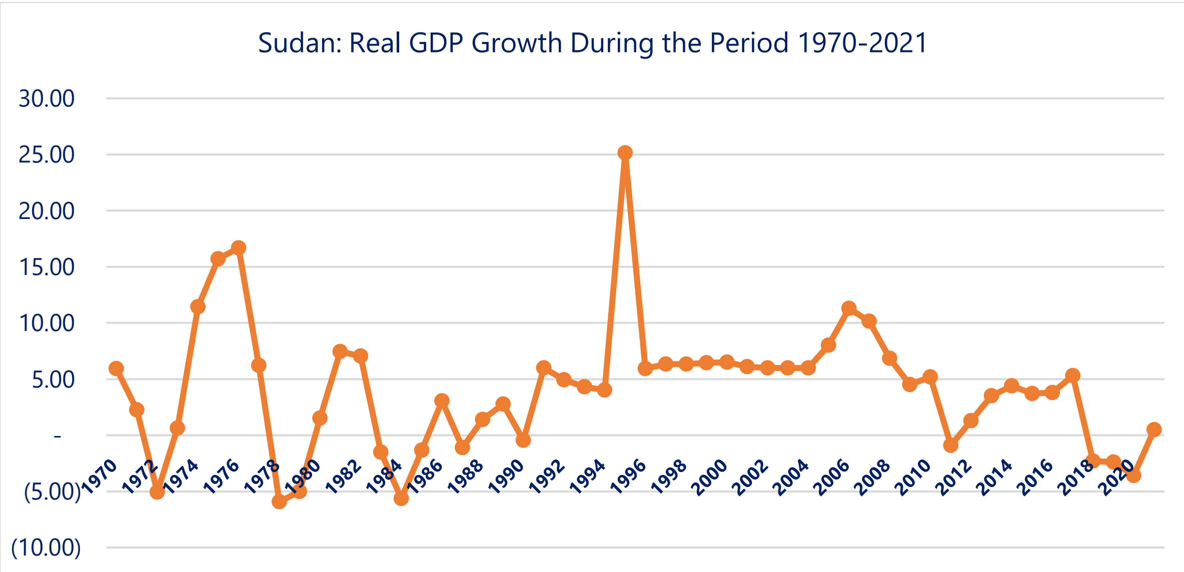
Source: Economic & Financial Review Report; Central Bank of Sudan

The figure above shows that Sudan is a cash society. However, with the acceleration of transformative technologies, a strategy must be developed to reduce the use of cash and move Sudan towards becoming a "cashless society." This would aid in the effectiveness of monetary policies. In early February 2018, we observed a 1% decrease in the bank currency ratio due to the banknote shortage. Therefore, it is essential to enhance the efficiency of the country's payment systems.

5. The banking sector under the transitional government

5.1 Macroeconomic imbalances constrained banking sector reform efforts

When the post-Bashir era transitional government assumed office in August 2019, they faced daunting banking challenges and contraction of the Sudanese economy, with GDP estimated to have contracted by 2.3 percent in 2018 and by 2.5 percent in 2019, reflecting weak competitiveness, a difficult business environment and the repercussions of the social and political turmoil.[30] GDP also contracted by a further 3.6 percent in 2020 due to the COVID-19 pandemic and its severe impact on international trade and domestic economic activities. However, the GDP grew by an estimated 0.5% in 2021. Growth was supported by agriculture and mining on the supply side and private consumption and investment on the demand side. The recovery followed several years of economic contraction stemming from macroeconomic imbalances, structural deficiencies, and political instability. Growth should be positive, inclusive, and shared by all.



Guided by the IMF's SMP, the CBoS adopted a new monetary policy in 2021 to boost credit growth and economic activity. Inflation more than doubled from 163.3% in 2020 to 358.9% in 2021, owing to currency depreciation and removal of fuel subsidies. Banks dominated the financial sector, accounting for over 80% of total assets. Fiscal consolidation and improved public revenues, as COVID-19 restrictions were eased, reduced the fiscal deficit to 4.5% of GDP in 2021 from 5.6% in 2020.[31]

Sudan reached a "decision point" under the HIPC initiative in 2021, cutting its $56 billion external debt (163% of GDP) by 50%. The current account deficit increased to 10.0% of GDP in 2021 from 8.3% in

[30] IMF Staff Monitored Program, "Staff Report," October 2020, https://www.imf.org/-/media/Files/Publications/CR/2020/English/1SDNEA2020003.ashx

[31] AFDP, "Sudan Economic Outlook," available at https://www.afdb.org/en/countries/east-africa/sudan/sudan-economic-outlook

2020, with higher imports after the lifting of COVID-19 restrictions, offsetting the pickup in exports arising from improved external demand. The account deficit in 2021 was financed by portfolio investments and external borrowing. International reserves remained very low at 0.3 and 0.4 months of imports in 2021 and 2020. Poverty increased from 55.4% in 2020 to 55.9% in 2021 and unemployment remained high at 18% in 2020.[32] Sudan's GDP was 34.33 billion US dollars in 2021, according to official data from the World Bank, representing 0.03 percent of the world economy.

5.2 Inflation

Inflation in Sudan reached a record high of 423% in July 2021,[33] which was attributed to the sharp rise in the cost of food, household supplies, and essential services. The cost of inflation was even higher for the banking sector and businesses. Due to the negative relationship between inflation and banking sector development, the banking industry was devastated, with investors paying the price in many cases, since increases in inflation interfered with the ability of the financial sector and businesses to allocate resources effectively. Staggering inflation impacted the banking industry, lending activity and market development diminished rapidly, accompanied by higher interest rates which discouraged borrowing, often used to invest in new business opportunities. Consumer savings were adversely affected, as borrowers benefit at the expense of lenders (banks) when real interest rates fail to keep pace with inflation.

Inflation also causes uncertainty, which further discourages business. In many cases, businesses failed to pass rising costs on to consumers, forcing them to shut down and/or reduce employment. In addition, since inflation in Sudan is much higher than in its trading partners, local exporters faced uncompetitive prices in external markets while local producers faced difficulty selling their products since similar imported products were cheaper and flooding the local market. Declining exports and booming imports caused Sudan's external trade deficit to grow. As a result, the high inflation slowed economic growth and employment.

The key cause of the rapid rise in inflation was the money growth resulting from uncontrolled government borrowing from the CBoS to fill the budget deficit gap. The transitional government started implementing some policy adjustments to curb the inflation rise, in August of 2021 Sudan's annual inflation rate came down to 387.6% from a record high of 423% in July.[34] It was the first slowdown in the rise in consumer prices under the two-year-old transitional government, as the currency showed signs of stabilizing following tough economic reforms in the previous months. These reforms were backed by the IMF to enable the country to qualify for debt relief, which included removing diesel and petrol subsidies and declaring a managed float of the Sudanese pound to stem the black market.[35] Based on Sudan Central Bureau of Statistics numbers the average inflation rate in Sudan decreased to 164.2 percent in December 2022 from 318.2 percent in December of 2021.

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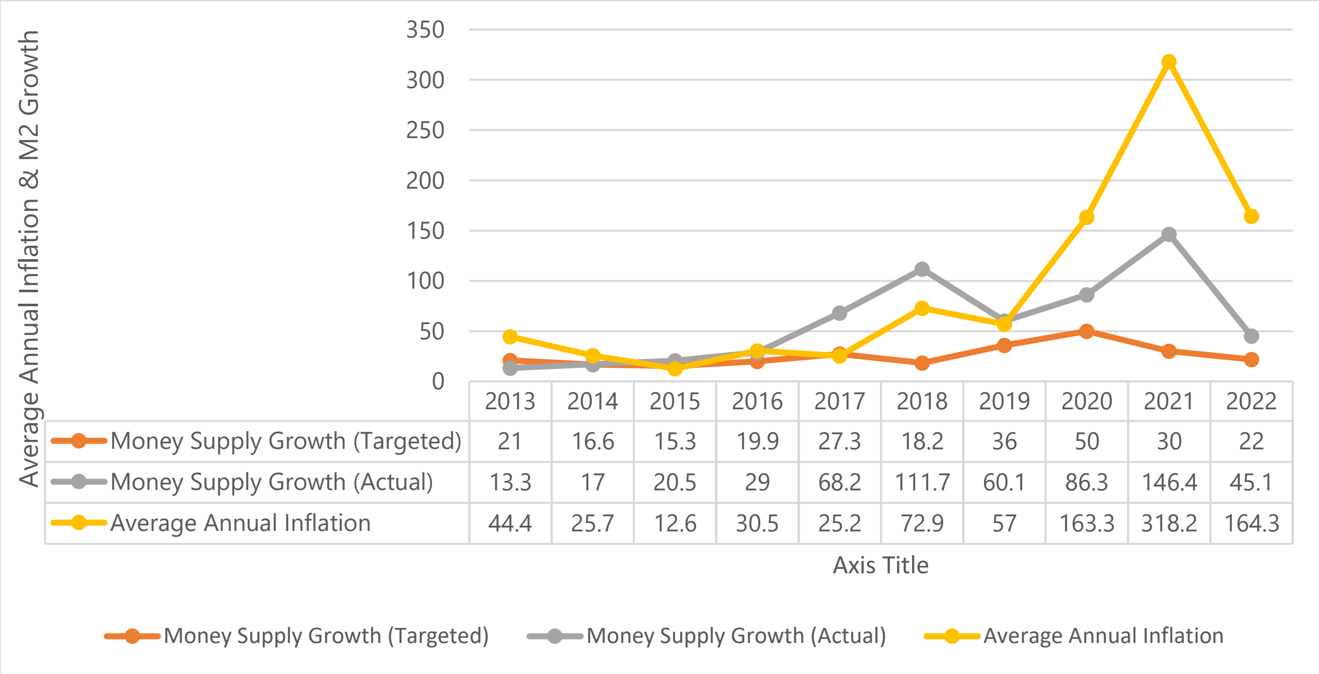
[32] AFDP Sudan Economic Outlook https://www.afdb.org/en/countries/east-africa/sudan/sudan-economic-outlook

[33] WFP Market Monitor, "Sudan: August 2021 https://reliefweb.int/report/sudan/wfp-market-monitor-sudan-august-2021

[34] WFP Market Monitor - Sudan: August 2021 https://reliefweb.int/report/sudan/wfp-market-monitor-sudan-august-2021

[35] Trading Economics, "Sudan Inflation Rates," available at https://tradingeconomics.com/sudan/inflation-cpi



	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Money Supply Growth (Targeted)	21	16.6	15.3	19.9	27.3	18.2	36	50	30	22
Money Supply Growth (Actual)	13.3	17	20.5	29	68.2	111.7	60.1	86.3	146.4	45.1
Average Annual Inflation	44.4	25.7	12.6	30.5	25.2	72.9	57	163.3	318.2	164.3

5.3 Foreign exchange issues

When the transitional government took office in August 2019, they faced a shortage of foreign currency which had placed Sudan's economy under considerable stress for decades and will continue to do so if not addressed. A shortage of foreign currency available through official channels pushes importers to acquire foreign currency illegally from the black market at higher rates and creates incentives for smuggling. Numerous devaluation episodes were implemented to alleviate Balance of Payments (BOP) deficits, domestic demand management, boosting agricultural sector production, stabilizing the financial sector, etc. Consequently, the Sudanese currency depreciated sharply over the period from November 1978 to January 2021.

Banking sector vulnerabilities have increased considerably, as a result of the direct and indirect effects of sharp currency devaluations, especially over the last decade. The devaluation not only affected banks' balance sheets directly, but it also generated significant macroeconomic and fiscal pressures which are likely to generate indirect and second-round effects. For instance, banks' asset quality sharply deteriorated as economic growth continued to slow, and inflation increased.

As noted above, the prevalence of exchange in the black market adversely impacted Sudanese banks since in most cases they were not part of the export and import process. The customs exchange rate was also extremely overvalued, set at 15 SDGs to the USD. This encouraged smuggling and negatively impacted government revenue, which significantly contributed to Sudan's budget deficit, high inflation, and exchange rate depreciation in a vicious cycle. Inflation continues to rise, rapidly eroding Sudanese citizens' purchasing power and outstripping any benefit they may have received from subsidized commodities or cheaper imports.

In the same vein, the impact of the sequence of exchange rate devaluations from June 2012 to October 2018 was transmitted into banks' capital through their FX positions. At present banks have a relatively low ratio of foreign currency to total financing and the currency structure of their risk-weighted assets (RWAs). Currency depreciations increase the foreign currency portion of RWAs (the denominator of CAR) for all banks, and since capital (the numerator of CAR) is fully denominated in local currency, the overall CAR decreases. As a result, the overall CAR of the banking system decreased by 8.3 percentage points from 15.4 percent in December 2019 to 7.1 percent in December 2021.

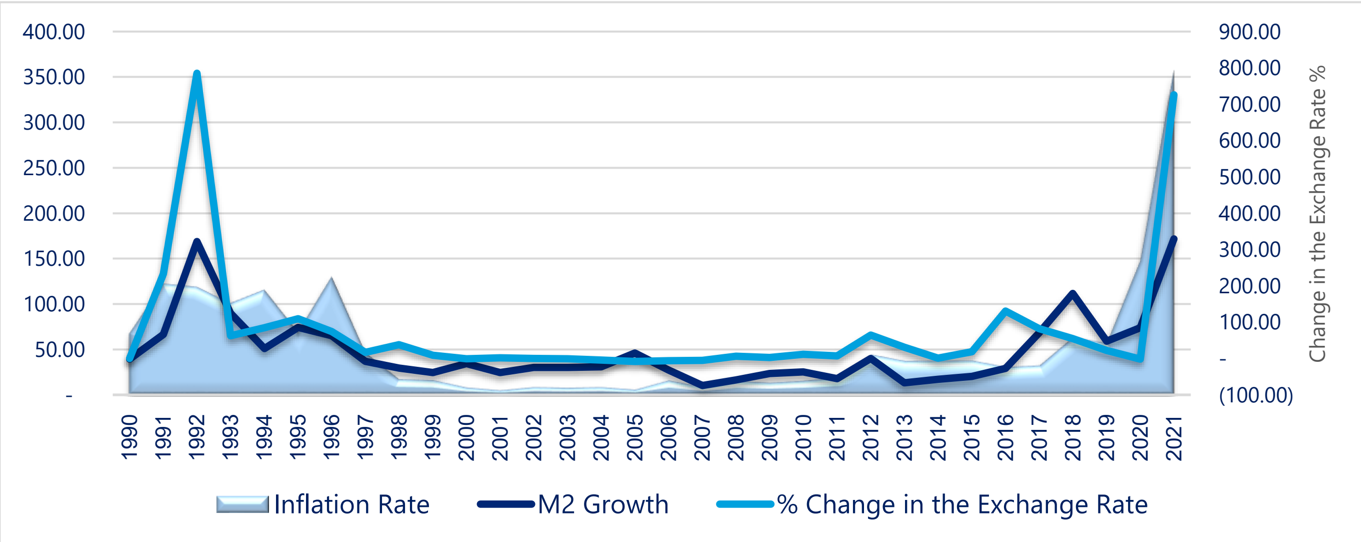
Even if the FX position at the system level is relatively low, the vulnerability of individual banks to FX risk can be very high. As of 2019, the banking system presented a short net FX position amounting to SDG 3.6 billion or 17.6 percent of capital and reserves. Thus, any unit of local currency depreciation results in an automatic decrease of capital at the system level of 17.6 percent. However, at the individual bank level, the vulnerability to FX risk can be significantly higher, as net FX position to capital varies from 323 to -240 percent.

In the first week of March 2020, the exchange rate for the US dollar on the black market jumped to 113 SDG for one US dollar from 107 SDG the previous week and peaked at around 400 SDG per USD prior to unification of the rates. Such pressures create strong incentives for capital flight, as those with wealth may seek to illicitly transfer their money out of the country and convert it to foreign currency in overseas jurisdictions. This leads to a loss of capital that might have otherwise been invested in productive activities needed to support long-term national economic development.

It is worth remembering that the transitional government announced the unification of the SDG to USD exchange rate on February 21, 2021, aligning the official SDG 55 with that of the parallel market, at the time SDG 375 to one USD. The policy ended decades of multiple currency practices (MCPs) that represented a major problem for the national economy. Many economists said the policy was untimely and likely to add to the suffering of the population, but the government defended it, saying it would attract investment and official development assistance, eliminate the parallel market, and encourage the sizable Sudanese migrant worker population to send remittances through official banking channels. Although changes in exchange rates may appear to be the cause of subsequent movements in prices and wages, the probable cause of both the exchange rate depreciation and domestic inflation was expansionary monetary policy.

The below graph reveals an excessive increase in the money supply, which would normally lead to a depreciation of the exchange rate, increasing the price of imported goods and services and thereby raising domestic prices and inflationary pressures. To stop this spiral of the exchange rate pass-through on inflation the transitional government adopted strict measures for monetization in 2021 to stabilize the exchange rate and to reduce inflation.

Factors Affecting the Exchange Rate in the Long Run: Growth in Money Supply (M2), Inflation & Change in Exchange Rate



Source: Annual reports, Economic & Financial Review Reports; Central Bank of Sudan

Under the transitional government, Sudan re-opened itself to the world and restored normal diplomatic and economic relations with international financial institutions and donors. In December 2020, the efforts of Sudanese diplomacy culminated in Sudan’s removal from the United States Sponsors of Terrorism List (SSTL), which allowed the Sudanese government to receive US financial aid and further normalize engagement with international financial institutions (IFIs).

In February 2021, the Joint Committee of the Sovereign Council and the Cabinet passed key legislative initiatives including laws on investment, public-private partnerships, and anti-corruption.

The transitional government adopted the dual financial system (allowing Western banking in addition to Islamic) in April 2021 and updated relevant regulations to adapt to the new banking business model. The dual banking system was introduced mainly to attract both foreign and domestic investment in the banking sector to improve financial inclusion, introduce advanced corporate governance into Sudan's financial market, and facilitate foreign/domestic investments.

The Board of the CBoS approved an amended Central Bank Act, prepared with the support of the IMF and WBG, and submitted it to the cabinet on October 12, 2021, following revision by the Ministry of Justice. To date, it has not been approved. This Act focuses on the following:

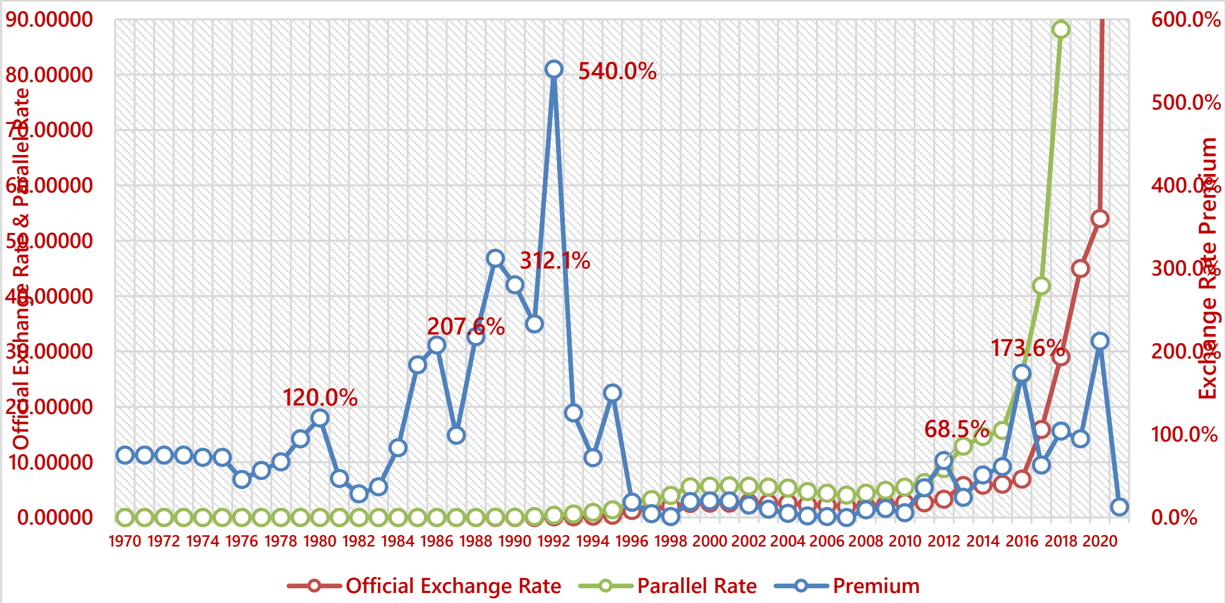
- establishing a central bank mandate focusing on price stability;
- strengthening the Central Bank’s institutional, functional, personal, and financial autonomy, including by limiting monetary financing of the government and prohibiting the central bank from conducting quasi-fiscal operations;
- improving the CBoS’ decision-making structure, by ensuring collegial decision-making;
- providing for effective oversight over the executive; and
- and enhancing transparency and accountability provisions.

If implemented, the law would address governance weaknesses, facilitate an increase in private investment, and create a banking system that is better suited to the needs of a modern economy and a reserve targeting monetary policy.

The transitional government also took steps to improve commercial banks’ soundness and to strengthen their governance structures. As of September 2021, the CBoS also completed, with the IMF and the WBG, a revised Banking Regulation Act which includes a comprehensive resolution regime for the banking sector, in line with international best practices (this was not submitted to the MOJ).

In the same context, the CBoS also completed the second phase of bank-by-bank stress tests to assess the impact of exchange rate shocks and recommended remedial measures, to strengthen commercial bank capital, including recapitalization and restraining dividends payout. In addition, the CBoS completed phase one of the AQR with the assistance of external partners, which includes 17 banks. Once the process was complete for all banks, the CBoS was to adopt an action plan for strengthening the banking sector including operationalizing the resolution regime and divesting CBoS shares in banks.

Sudan's Official Exchange Rate & Parallel Exchange Rate & Exchange Rate Premium During the Period (1970-2021)



5.4 Banking sector reforms

The reform priorities in the ECF arrangement focus on increasing central bank independence, strengthening the financial sector by implementing a dual system and reforming the bank resolution regime and served as the basis for the reforms planned by the 2019-2021 transitional government, including:

1. Strengthening CBoS independence and its supervisory capacity through regulatory supervision modernizing banking regulations in line with Islamic Financial Stability Board and international standards and moving to risk-based supervision.
2. Enacting a revised Banking Business Regulation Act, which includes a comprehensive resolution regime for the banking sector, in line with international best practices.
3. Ensuring that banks comply with corporate governance standards in line with the Basel Committee on Banking Supervision Corporate Governance Principles, including conflict of interest and related party transactions.
4. Completing phase two of the AQR with assistance from external partners and adopting an action plan for strengthening the banking sector including operationalizing the resolution regime and divesting CBoS shares. The resolution regime will lay the groundwork for the CBoS to restructure the banking sector, through liquidation and/or merger and acquisition.
5. Operationalizing a dual system of conventional and Islamic banking to expand access to credit. The dual banking system will help to attract both foreign and domestic investment in the banking sector and throughout the economy, improve financial inclusion, and introduce advanced corporate governance into Sudan's financial markets.
6. Transiting to a reserve-money targeting regime facilitated by the dual banking system. This requires the Treasury Committee to establish a regular meeting mechanism to enhance coordination between the CBoS and MoFEP to improve liquidity management and forecasting to strengthen monetary control and foreign exchange management.
7. Strengthening the implementation of the AML/ CFT framework. This is needed to prevent abuse of the financial system and to broaden the limited network of correspondent banking relationships.

5.4.1 Planned banking policies

The reform program agreed upon between the 2019-2021 transitional government and the IMF, built on these principles and contained a set of goals to reform the banking sector, and the economy and KPIs to measure the achievement of those goals as well as the risk associated with the implementation. Below are the main goals of banking reforms planned by the transitional government:[36]

1. **Strengthen CBoS independence and effectiveness** as a critical component of an economic strategy to limit government monetary financing and strengthen central bank governance, including reforming the CBoS act, limiting monetization of deficits, and establishing a mandate based on price stability. CBoS effectiveness is a crucial factor in achieving its independence.

2. **Strengthen CBoS's capacity to supervise and mitigate financial stability risks** by:
    a. Reviewing and modernizing banking regulations.
    b. Enhancing supervision to ensure that banks comply with regulations.
    c. Establishing regular communication channels between supervision and regulation departments.
    d. Conducting semi-annual stress tests for banks to identify and address vulnerabilities of individual banks.
    e. Completing AQRs of important banks based on international standards.
    f. Strengthening the bank recovery and resolution framework to be based on international best practices.
    g. Replacing CBoS officials serving on commercial bank boards with independent directors.
    h. Transferring CBoS ownership in commercial banks to the MOFEP or to selling ownership to the public.

3. **Strengthen financial sector soundness and mitigate risks**, including strengthening corporate governance in the banking sector in line with the Basel Committee on Banking Supervision Corporate Governance Principles and applying enhanced risk-based AML/CFT supervision. Addressing AML/CFT deficiencies is a top priority, and this can be done by:
    a. Completing a national ML/TF risk assessment.
    b. Increasing the capacity of the Financial Intelligence Unit (FIU).
    c. Implementing full risk-based AML/CFT supervision.
    d. Improving the process of freezing terrorist assets.

4. **Finalize an amended CBoS Act** to ensure:
    a. That the mandate focuses on price stability.
    b. Stronger CBoS institutional, functional, personal, and financial autonomy, including by limiting monetary financing of the government and prohibiting the CBoS from conducting quasi-fiscal operations.
    c. An improved decision-making structure, by ensuring coordinated decision-making, providing for effective oversight over executives; and enhancing transparency and accountability provisions.

5. **Unify the exchange rate. But as a pre-requisite, the government tried to do the following:**
    a. Complete bank stress tests to exchange rate shocks and develop remedial measures to address identified weaknesses (implemented for 17 out of 39 banks).
    b. Pass a revised 2020 budget consistent with the SMP program objectives.
    c. Mobilize revenue through customs exchange rate reform and expansion of the tax umbrella.

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[36] International Monetary Fund, "Staff-Monitored Program – Press release," October 2020, available at https://www.imf.org/-/media/Files/Publications/CR/2020/English/1SDNEA2020003.ashx

   d. Improving monetary policy, especially policies to help to contain inflation.
   e. Establishing an active treasury committee to enhance coordination between CBoS and the MOFEP to improve liquidity management and forecasting to strengthen monetary control.

6. **Strengthen governance and curb corruption**, by implementing structural reforms to improve governance, fight corruption, and strengthen the business environment to support higher and more inclusive growth through the following actions:
   a. Approve an Anti-Corruption Law.
   b. Establish an independent Anti-Corruption Commission with a strong mandate.
   c. Strengthen oversight and corporate governance rules for public enterprises.
   d. Reinforce public financial management.
   e. Strengthen the role of civil society and journalists in combating corruption.
   f. Enhance oversight of state-owned enterprises (SOEs) by preparing and publishing an inventory of all SOEs, including those supervised by the Ministry of Finance, line ministries, and the security sector.
   g. Transfer oversight responsibilities for SOEs (excluding purely military companies) to the MoFEP, apply corporate governance rules on SOEs, and assess the strategic objectives of SOEs and the role of government, with the aim of determining which should remain public and which should be privatized.

7. **Unlock Sudan's private sector development potential as a key for more inclusive growth** through:
   a. Improving the investment climate.
   b. Fostering public-private dialogue.
   c. Strengthening the legal and institutional framework for Public-Private Partnerships (PPPs).
   d. Supporting the development of small and medium-sized enterprises, focusing on access to finance, business entry and taxation, innovation, and entrepreneurship.
   e. Establishing a new Investment and Private Sector Development Authority.

8. **Adopt an automatic fuel pricing mechanism** to eliminate subsidies and ensure that retail diesel and gasoline prices reflect all costs.

9. **Strengthen coordination among various technical assistance (TA) providers** with a focus on areas that support fiscal consolidation, monetary and financial sector reforms, improving governance, and upgrading CBoS capacity to supervise and mitigate financial stability risks.

10. **Set up an active treasury committee to enhance coordination between the CBoS and the MOFEP** to improve liquidity management and forecasting to strengthen monetary control.

11. **Put more effort into obtaining much-needed debt relief and regaining access to external financing** including:
   a. Stepping up outreach efforts to Sudan creditors to rally broad support for debt relief.
   b. Continuing cooperation with the IMF and the WB on economic policies with a view to establishing a track record of sound macro policies.
   c. Committing to developing a full-fledged *Poverty Reduction Strategy* (PRSP).

The transitional government and the IMF agreed on a 12-month SMP with semi-annual reviews, from July 2020–June 2021[37] applying quantitative benchmarks to use or evaluation to a number of targets.

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[37] International Monetary Fund, "Staff-Monitored Program – Press release," October 2020, available at https://www.imf.org/-/media/Files/Publications/CR/2020/English/1SDNEA2020003.ashx

5.4.2 Banking Sector Reform Implementation Risks

Below are some of the expected risks that can stem from the SMP program implementation, countermeasures need to be taken to mitigate those risks as much as possible:

1. Limited public tolerance for policy adjustment may trigger social tensions.
2. Limited financial support from donors to support reform.
3. Staggering inflation.
4. Exchange rate adjustment pressures on citizens and businesses.
5. Weak capacity to implement reform.
6. Fragile social and economic conditions.
7. Lack of governance and spread corruption and weak institutional capacity.
8. The absence of corporate governance and guidelines for the country's state-owned enterprises has adversely affected the independence and oversight authority of its institutions.
9. Political instability.

6. The Impact of the October 2021 Coup on the Banking Sector

On October 25, 2021, the Sudanese military carried out a coup and overthrew the transitional civilian government. The coup was condemned by foreign donors and international financial institutions, who immediately terminated cooperation with Sudan. In the year following the coup, coup leaders reversed the progress made between 2019 and 2021 and exacerbated the cost-of-living crisis, price hikes, and business-sector recession. It both worsened the economic situation in the country and deprived it of much-needed international funding and support, disproportionately affecting vulnerable groups in Sudanese society.

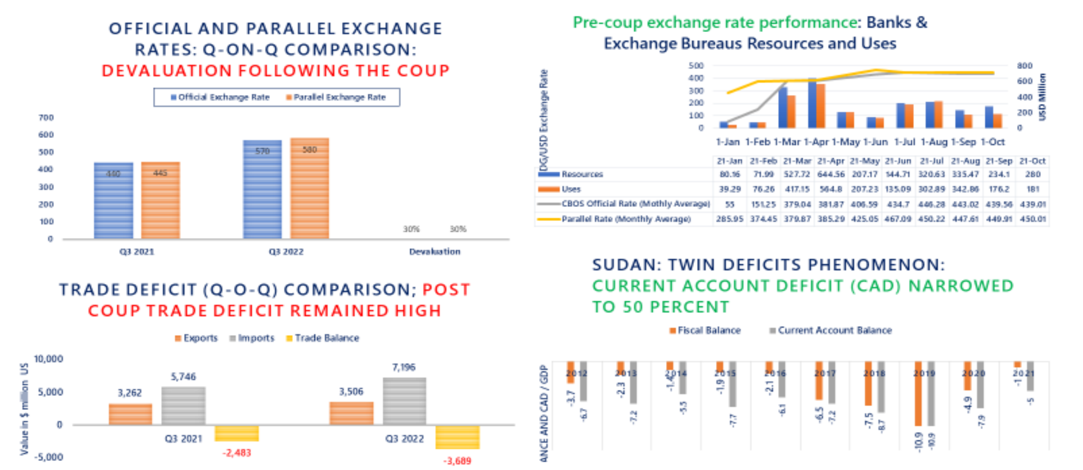
The 2019-2021 authorities had established a strong track record of reform of the banking sector under the ECF. However, the banking sector remained fragile, with several banks undercapitalized and/or vulnerable to macroeconomic shocks as a result of the coup and its economic aftermath. More than one year after the coup, most of the reforms planned for the financial sector had slowed or stopped including:

1. Implementation of fiscal and monetary policies,
2. Commercial banks restructuring and reform,
3. Implementing the dual banking system,
4. Enhancing CBoS's capacity to execute its supervisory and regulatory role,
5. Digital transformation and financial inclusion efforts.
6. Capacity building for CBoS staff to effectively execute their regulatory and supervisory roles.
7. Cooperation with international and regional financial organizations.
8. Integration of commercial banks into the global financial system to enhance correspondent banking relationships.
9. Measures to address corruption in the banking sector.
10. Combined programs to mitigate the impact of currency exchange rates which resulted in many banks struggling to survive and a devastating impact on citizens as well as businesses.

Overall, macroeconomic fundamentals have continued to deteriorate since the coup, macroeconomic imbalances have returned, and this will affect the banking system's ability to absorb shocks. However, adequate monetary policy framework and resilience of the banking system requires exchange rate stability at a sustainable market-clearing level, in addition to low inflation, and restoring external sector imbalances.

to the limited availability of precise information, it is currently difficult to determine the exact extent and magnitude of the infrastructure loss for banks, in both headquarters and branch locations. However, according to news reports, critical infrastructure such as buildings, furniture, computers, electronic systems, banknotes, and gold in the bank vaults have been looted or suffered significant damage. While precise forecasts are not possible at this stage, the economic loss is believed to be substantial.

Macroeconomic Imbalances Have Returned following the Coup



7. The Impact of the 15 April War on the Sudanese Banking System

Since April 15, the war in Sudan has resulted in tragic loss of life and human suffering, as well as causing massive damage to Sudan's physical infrastructure. It has displaced more than 5.1 million.[38] The situation is catastrophic, and the economic consequences are already very serious. Prices of basic commodities have surged as a result of scarcity, putting pressure on the vast majority of Sudanese. Price shocks will have an impact on everyone, but especially on poor households for whom food and fuel are a higher proportion of total expenses. Infrastructure has been hit, meaning that the country will face significant recovery and reconstruction costs.

The impact of the war on macroeconomic indicators

As a result of the ongoing war and its political ramifications, several macroeconomic factors are expected to create significant challenges for the Sudanese banking system. These include:

1. **Rise in the inflation rate (surprise inflation):** The ongoing conflict and instability may lead to an increase in the inflation rate, linked to expansionary monetary policy.
2. **Rise in the budget deficit and reliance on the Central Bank of Sudan (CBoS):** The prolonged war may lead to an increase in the budget deficit. To contain this deficit, the government may

[38] OCHA Situation Report, September 7, 2023, available at https://reports.unocha.org/en/country/sudan/

borrow from the CBoS to cover its urgent liabilities. This may strain the bank's resources and lead to further economic imbalances.

3. **Lack of external financing and grant inflows**: The conflict and political instability may result in the suspension of foreign loans and grants to the country. During the transitional period, Sudan received a total of $4.6 billion in commitments from the international community. However, Sudan was only able to benefit from 6 percent of this amount, with a total disbursement of $268 million, before the coup on October 25, 2021, halted payment of the remaining 94 percent ($4.3 billion).

   In December 2022, following the signing of a framework deal, donors committed to resuming the disbursements, but this has been halted again by the outbreak of the war. Thus, both the coup and the war have played a role in the suspension of aid.
4. **Chronic trade deficit**: Sudan had a massive trade deficit prior to the war. The war may increase the trade deficit, putting pressure on the country's foreign exchange reserves.
5. **Massive shortages of the country's foreign exchange reserves:** Extended conflict and economic challenges will create more bleeding for the foreign exchange reserves of the country. Insufficient reserves make it difficult for banks to meet demands for foreign currency, affecting their operations and ability to facilitate foreign trade transactions.

In addition to creating changes at the level of the macro-economy, the war created a number of key challenges for the economy, including:

1. **Damage to infrastructure:** Many factories and mills have been damaged by war, looted, and set on fire, resulting in significant losses for investors. The destruction of infrastructure and equipment reduces production capacity, leading to a decrease in output and revenue. This may further lead to layoffs reducing the buying power of workers, which can have adverse effects on the overall economy.
2. **Challenges for agriculture:** The lack of access to imported components, financing, fuel, fertilizers, and manpower for Sudan's summer agricultural season will likely have a significant impact on crop production. The instability is also likely to affect access to markets.
3. **Looted bank branches:** The attacks on bank branches in Khartoum and western cities, looting of banknotes, and destruction of infrastructure, looting of tens of thousands of homes and small businesses, and shops in Sudan have undoubtedly caused severe damage to individuals and the economy as a whole. The consequences are far-reaching and can have long-lasting effects on investors and the ability to rebuild and recover after the war.

In addition to the problems listed above, there are a number of operational challenges to the banking sector, including

1. **Infrastructure damage to banks:** Due to the limited availability of precise information, it is currently difficult to determine the exact extent and magnitude of the infrastructure loss for banks, in both headquarters and branch locations. However, according to news reports, critical infrastructure such as buildings, furniture, computers, electronic systems, banknotes, and gold in the bank vaults have been looted or suffered significant damage. While precise forecasts are not possible at this stage, the economic loss is believed to be substantial.
2. **Theft of Sudanese banknotes:** The theft of a significant number of Sudanese banknotes, whether from banks or individuals, poses a challenge to the stability and management of the currency.
3. **Impact of the war on brain drain:** The flight of banking and financial employees as a result of the war especially if they find opportunities abroad, can create a significant gap in expertise and experience within the industry.
4. **Centralization of banking operations:** The centralization of banking operations in Khartoum and heavy dependence on headquarters, most of which are now in a war zone, can severely impact the functioning of branches located in other states.
5. **Impact on banking digital infrastructure:** The war's impact extends beyond the financial aspects. The infrastructure of the banking sector, including core banking systems, software, and

hardware, suffered damage or disruption. This impedes the delivery of financial services and decreases the sector's attractiveness for deposits and investments.

6. **Reduction of lending capacity:** Even before the war, financial intermediation in Sudan was below the Sub-Saharan Africa (SSA) average. Financing to enterprises and households stood at 9.5% of GDP against the SSA average of 18.8 percent.[39] Lending activity is expected to shrink further as banks are less able to engage in financial intermediation activities and provide necessary credit and financing to targeted economic sectors due to the loss of assets and inflation likely to be associated with the war, as well as increased fear of default.
7. **The deterioration of asset quality:** The financial sector was vulnerable prior to the war due to the weak economy, and it is expected that vulnerabilities and risks will increase as a result of the war. In particular, the anticipated devaluation in the national currency, external sector imbalances, monetary financing, and temporary advances from CBoS to MOFEP will have a direct negative impact on banks' capital positions and – through higher inflation and low growth – are expected to worsen the borrower's repayment capacity, leading to a likely deterioration in asset quality.
8. **The deterioration of correspondent banking relationships (CBR):** The banking system has been constrained by the lack of correspondent bank relations, which have not been restored despite Sudan's de-listing from the State Sponsors of Terrorism List in December 2020. The lack of international CBR is a severe restriction on the Sudanese economy and has prevented Sudan from benefiting from economic reintegration. The lack of CBR limits the services banks can offer, especially for valuable commercial customers. To the extent that these restrictions limit opportunities for growth and raise transaction costs, the problem creates political risk for the government and lowers the quality of life of Sudanese citizens. Establishing correspondent banking relationships requires building credibility and trust that the Sudanese government and financial institutions understand the importance of anti-money laundering and combating the financing of terrorism (AML/CFT) compliance and are putting in place the necessary policies, systems, and practices. However, the ongoing war, the Central Bank of Sudan (CBoS) has halted the plan for a mutual evaluation led by the Financial Action Task Force (FATF) to assess Sudan's progress in AML/CFT compliance.

Overall, the ongoing war poses significant challenges to the banking system. These challenges include erosion of capital, deterioration of asset quality, impact on infrastructure, decreased attractiveness for deposits and investments, and increased operational expenses due to physical damage. These challenges are discussed in further detail in STPT's recent paper, "The Banking System During and After the War: Challenges and Policy Recommendations."

8. Recommendations for Reforming the Sector

Sudan is a complex and fragile state with limited institutional capacity, weak governance, and a consistent stream of corruption which undermines economic growth, amplifies income inequality and erodes public trust in institutions. The October 2021 coup and April 2023 war added fuel to the fire and brought the Sudanese economy to its knees, exacerbating risks to banks' financial positions resilience and soundness. Hence the next government must address this sector as a priority to get the economy back on the right track. Banking sector reforms must be carefully designed and executed in phases to reduce. the risks of failure. One immediate action that should be taken would be to increase the timeliness, quality, and integrity of data and statistics, another is to build a culture of transparency and accountability in the banking sector.

[39] Sudan: Financial Sector Assessment Program, World Bank report on the Banking System, Economic & Financial Review, Quarter IV, CBoS, Annual Report 2021.

In the short term, to recover from the war, the government and other concerned actors will need to understand a variety of measures to stabilize the economy. These include:

1. Managing inflation
2. Adopting an expansionary fiscal policy
3. Improving access to finance (in particular restoring access to digital payment platforms)
4. Promoting the development of decentralization and interoperability
5. Mandating business continuity plans
6. Promoting the use of digital cash subsidies for short-term recovery.

In the longer term, a more comprehensive bank reform is needed. Below is a high-level summary of recommendations for an eventual next government to help it define its vision for guiding priority reforms of the banking sector that should be implemented as a matter of urgency and alongside other reforms:

1. Enhance the CBoS' independence, **credibility**, **accountability, coordination, and transparency**.
2. Enhance CBoS capacity for policy formulation, evaluation & execution
3. Improve the CBoS structure.
4. Enhance the human resource capacity of the banking industry.
5. Strengthen banking sector transformation and oversight.
6. Increase efficiency of the banking sector.
7. Address the current challenges in commercial banks so that they can contribute effectively to economic development, including by improving corporate governance in the banking sector.
8. Address issues in government-owned banks, especially ownership.
9. Implement a digital transformation strategy and roadmap to achieve financial inclusion and accelerate the implementation of digital financial services (DFS).
10. Implement the dual banking system and address its current challenges.
11. Establish and execute a roadmap to integrate the financial sector into the global financial system.
12. Position the banking sector to contribute to the fight against financial and economic corruption.
13. Remove obstacles to venture capital and equity funds for start-ups and fintech.
14. Enhance credit infrastructure, secured lending, electronic collateral registries, insolvency and creditor protection, and
15. Reform agricultural finance and role of policy banks.

8.1 Central Bank of Sudan (CBoS) Reforms

8.1.2 Ensure CBoS Independence

Due to decades of political influence, the enforcement function of CBoS was marginalized.[40] As a result, people lost trust in the CBoS, which became unable to enforce its own guidelines or execute its supervisory function effectively. A strong regulator is necessary to enforce and execute its policies without exception. To achieve this the following should be prioritized:

1. Restore CBoS independence from political interference

This can be addressed by upgrading CBoS capacity to focus more on fulfilling its key mandates (details below). This will require the removal of functions that are outside the CBoS mandate and eliminating activities that run counter to financial stability objectives.

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[40] Committee on the Economic Emergency Subcommittee on Banking Reforming Sudan's Banking Sector May 2020 (not published)

Key recommendations to enhance CBoS independence include:

a. The appointment of the Governor and Deputy Governors should not be influenced by any ministry or PEP.
b. Prohibit the CBoS Governor, Deputy Governors, board members, and staff from occupying any office or having an interest in any bank or non-bank financial institution including in which the CBoS has ownership.
c. The CBoS Governor or his/her designates should not be part of the management of external entities at any level, including state-owned enterprises.
d. Legally protect CBoS staff to ensure that they can effectively execute their supervisory role.
e. Replace all CBoS staff who currently hold roles as board members in banks with independent experts.
f. Review and approve a robust new Central Bank law.
g. Eliminate any conflicts of interest that may interfere with Central Bank functions.
h. Equip the CBoS with the power needed to execute its supervisory role.

2. **Rebuild CBoS credibility by executing its enforcement functions including but not limited to:**[41]
   a. Eliminating any mandates that promote fiscal dominance and debt monetization.
   b. Applying stringent measures to address corporate governance issues in commercial banks including ensuring board of directors and managers compliance with CBoS guidelines, where appropriate through suspension.
   c. Synchronizing the CBoS & MOFEP to create realistic and credible annual planning for government financing needs factoring in inflation targets and the maximum credit growth permissible by CBoS to avoid excessive borrowing.
   d. Strictly prohibit financing currency or commodity speculation through the banking sector.
   e. Establish a business continuity plan with all banks to ensure they can remain open throughout the crisis.

8.1.2 CBoS to lead banking sector transformation

CBoS independence must come with **accountability, coordination, credibility, and transparency** and CBoS must have the capacity to fulfill its mandate. This must include:

1. Coordination between the CBoS and MoFEP to implement successful monetary policy to advance national economic objectives.
2. Policies and directives issued by CBoS should be well formulated in consultation with the main stakeholders so they can be supported and trusted by the market and be enforceable.
3. Enhance the transparency of CBoS communication both internally and to the public.
4. Enhance the effectiveness and timeliness of the formulation and implementation of policies and directives.
5. Review and overhaul the banking legal framework to comply with international standards, best practices, and market rules.
6. Utilize technology to improve CBoS main regulatory oversight roles.
7. Focus on achieving financial inclusion and expanding digital services and fintech.
8. Appoint independent board members to replace CBoS staff currently on Boards of Directors of commercial banks.
9. Transfer CBoS ownership of state-owned banks to the MoFEP as soon as possible.

[41] Committee on the Economic Emergency Subcommittee on Banking Reforming Sudan's Banking Sector May 2020 (not published)

10. Establish an independent Asset Management Company (AMC) professionally managed by the MoFEP and Social Security Fund to hold all government shares in commercial banks.
11. Reform the CBoS board of directors to have external experts and not to be chaired by the governor.

8.1.3 Improving CBoS' policy formulation & execution capacity

1. Ensure firm enforcement of CBoS policies against banks, or bank leaders (board directors and managers) who do not comply with CBoS policies or guidelines.
2. Penalize (including suspension of licenses) any bank that provides loans to finance currency and commodity speculation.
3. Form a Financial Stability Task Force (FSTF) from relevant stakeholders to ensure the safety and soundness of the banking system (details later).
4. Modernize the CBoS data infrastructure utilizing technology to improve the implementation of comprehensive data governance policies.
5. CBoS staff should be regularly appraised to determine training needs.
6. Promote the use of official channels for international remittance by providing intuitive channels and incentives to Sudanese expats.
7. Introduce effective policies to address any liquidity and solvency challenges that may face banks.

8.1.4 Strengthening banking sector oversight

Strengthen the supervisory and regulatory framework of the banking sector. These efforts should focus on:

1. Developing regulations to enhance corporate governance in banks and ensure banks comply with the regulations during onsite inspections.
2. Reviewing and approving bank shareholders, board members, and key executive functions by the CBoS focusing on both character and competence.
3. Developing a roadmap to reform commercial banks including mergers/acquisitions and recapitalization to attract more private domestic or foreign ownership.
4. Cementing risk-based supervision of banks.
5. Conducting stress tests and preparing financial stability reports on a regular basis.
6. Establishing a bank recovery and resolution framework, including establishing a deposit insurance company.
7. Designing effective systems and support tools and providing an opportunity to address deficiencies within certain banks. Such a system could include:
    a. Removing banks from specific support measures.
    b. Putting banks under enhanced supervision prior to undergoing corrective actions or resolution plans.
8. Setting up concrete plans to enhance correspondent banking relationships by
    a. Applying strong AML/CFT practices.
    b. Engaging the international community to provide support to Sudanese banks to upgrade their capacity and address compliance issues.
9. The mandates and performance of state-owned banks should be evaluated and revalidated. There are currently five such state-owned and specialized banks mandated to fill gaps in access to finance for individuals and specific sectors: the Agriculture Bank of Sudan, the Industrial Development Bank, the Savings and Social Development Bank, the Farmers Commercial Bank, and the Family Bank.

10. Develop a stronger AML/CFT regime to provide comfort to correspondent banks on the ability of Sudanese respondents to address money laundering and terrorism financing risks.

8.1.5 Align CBoS organizational functions with its core mandate

The CBoS should be transformed into a modern organization by enhancing the organizational structure, and human capital, through training and recruitment, workflows, and regulatory technology and aligning them with CBoS mandates.

1. Set processes and KPIs to manage CBoS performance effectively.
2. Build strong teams with the right capabilities to execute CBoS mandates with the effective use of resources.
3. Introduce a clear reporting framework and benchmarking of performance against international standards and comparable central banks in the region and internationally.

8.1.6 CBoS third-party review

For decades, Sudan has been deprived of participating in technology-driven advancement in organizational, management, and regulatory approaches in the banking and the broader financial sectors. To overcome these challenges and transform the CBoS into a modern organization with the structure and skills to effectively execute its policy and oversight functions, it is critical to have an independent third-party to review CBoS's organizational structure, business processes, and relationships between different internal departments as well as across government units, coupled with an assessment of staffing needs and relevant qualifications for each function. The outcome of the review would be a detailed diagnostic and recommendations.[42]

8.1.7 Improve transparency and data quality

1. Enhance data quality and data collection on both the supply and demand sides of the banking sector.
2. Improve the scope, consistency, frequency, and availability of data on both the supply and demand sides for financial products and services for the different types of institutions.
3. Enhance supervision and risk assessments by filling the data gaps in the in the banking sector.
4. Improve monitoring of vulnerabilities by improving data quality including loan classification, banking sector activities, and corporate exposures.
5. Improve the quality of oversight by enhancing transparency and consistency in data sharing across banks, other lending institutions, and the public.
6. Attract international and domestic capital by enforcing the adoption of international accounting, valuation, and auditing standards.

8.1.8 Enhance credit infrastructure

1. Develop a Unified Digital Collateral Registry (UDCR) to help banks manage lending risks.
2. Develop a proper insolvency system with strong secured lending rights in favor of creditors.

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[42] Committee on the Economic Emergency Subcommittee on Banking Reforming Sudan's Banking Sector May 2020 (not published)

3. Develop effective reorganization guidelines that will allow companies to reorganize under court protection.
4. Develop policies to ensure secured creditors will have priority claims in liquidation and allow for out-of-court enforcement of security interests.
5. Strengthen the Sudan Credit Information and Scoring Agency (CIASA) bureau by approving the new law and enhancing CIASA through capacity building.

8.1.9 Financial Stability Task Force (FSTF)

The banking sector is facing multiple challenges, and some banks are at the edge of the cliff. Urgent synchronized actions are needed by multiple stakeholders to stabilize the banking sector when the next government takes office to ensure the safety and soundness of the banking system and adequate liquidity to the economy at this critical time. To synchronize stabilization efforts, a Financial Stability Task Force (FSTF), should be established for a specified period. Suggested FSTF members are the CBoS, MoFEP, the Banker's Union, the Employer's Federation, relevant academics, and the Liquidity Management Fund in addition to expertise in financial technology, legal insolvency, communication team to conduct crisis planning, reporting, and information management. The FSTF would be able to quickly detect any solvency or liquidity problems and suggest timely coordinated action.

Some of the Task Force actions should be to[43]:

1. Oversee the execution of the recommendations of the Committee on the Economic Emergency Subcommittee on Banking's report *Reforming Sudan's Banking Sector* through a detailed action plan.
2. Ensure that sufficient liquidity and financial support exist for key priorities during the first year of the transitional government.
3. Coordinate with the MOFEP on fiscal policy measures, especially in foreign exchange operations.
4. Enable the CBoS and relevant organizations to carry out actions in response to solvency challenges.
5. Coordinate with the Ministry of Trade and Industry to intervene against speculative hoarding.
6. Focus on achieving objectives by utilizing government power to avoid bureaucratic and procedural obstacles.
7. Coordinate efforts between different government agencies to remove regulatory defragmentation and increase synchronization across fields related to banking, insurance, and capital markets.
8. Establish a clear communication strategy and increase information flow with market participants and the public to maintain confidence.
9. Employ high-frequency reporting and feedback to allow for timely response to liquidity needs to avoid insolvencies.

8.1.10 General economic reform measures

CBoS mandates are well integrated with other governmental units, and all should work in synchronization to address economic and banking sector issues through a comprehensive reform strategy. Some of the actions that directly impact the financial sector include:

1. Sustaining the unification of multiple exchange rates. Although this reform was already initiated in 2021, other measures are needed for this reform to succeed.

[43] Committee on the Economic Emergency Subcommittee on Banking Reforming Sudan's Banking Sector May 2020 (not published)

2. Creating a unified digital Single-Window solution for Export/Import to manage trade and customs transactions and to manage trade data from a single point.
3. Implementing preventive measures in relation to PEPs by enhancing the capacity of financial and non-financial institutions to know their customers, and their ability to detect suspicious transactions. If a suspicion arises, concerned transactions should be reported to the financial intelligence unit (FIU).
4. Improving the implementation of customer due diligence (CDD), including by non-bank institutions.
5. Publishing comprehensive asset declarations for PEPs to assist in reporting suspicious transactions and helping to implement requirements for PEPs.
6. Establishing a National Anti-corruption Commission with the right caliber and funding to build an anti-corruption action plan with a focus on banking sector violations.
7. Involving civil society and journalists in combating corruption, especially in the financial sector, and enhancing information sharing.

8.1.11 Expectations from international institutions

To accelerate banking sector reform, international institutions have to be involved in multiple ways including:

1. Extending technical assistance to Sudan's banking sector especially the Financial Intelligence Unit (FIU) to improve its capacity.
2. Assisting with integrating Sudanese commercial banks with the international financial industry.
3. Putting in place systems that more actively and effectively sanction overseas bribery payments.
4. Enhancing and enforcing anti-money laundering measures to help counter IFFs from Sudan by increasing its compliance with the international anti-money laundering standards of the FATF and in preparing for the mutual evaluation.
5. Pushing offshore financial centers, which make illicit financial out-flows possible in the first place by means of various secrecy mechanisms, to take countermeasures in their own spheres of influence.
6. Providing assistance to improve information sharing among jurisdictions through automatic exchange of information the systematic registration and disclosure of the beneficial ownership of companies, trusts, and other organizations.

8.2 Commercial bank reform

8.2.1 Restructure commercial banks to enhance their capacity

Commercial banks are facing many challenges and suffering from decades of bad management. The CBoS should develop a strategy for helping struggling banks achieve recovery, especially from bad loans. Some banks may need to be restructured to solve liquidity issues and address bad assets and non-performing loans as well as insolvency. The solution could lead to consolidation or merger of banks or through recapitalization. Some immediate actions need to be taken:

1. Enforce corporate governance in banks including adoption of specific board committees and adherence to CBoS policies and guidelines (details below).

2. Complete asset quality reviews of banks based on international standards and make it a regular process.
3. Develop parameters, best practices, and guidance on loan restructuring and risk management policies.

8.2.2 Establish corporate governance in commercial banks

Commercial banks should:

1. Enforce corporate governance responsibilities with close oversight from CBoS.
2. Assign appropriate governance structures, including appropriate board committees, to ensure compliance with CBoS regulations.
3. Apply the Basel Committee on Banking Supervision's Corporate Governance Principles to clearly define roles duties and responsibilities to senior management, board of directors, and shareholders.
4. Eliminate conflicts of interest by developing policies based on best practices.
5. Develop requirements to disclose information about board members' senior management and their relationship with other enterprises.
6. Attract Sudanese expats' funds by implementing effective international remittance solutions and providing incentives for Sudanese working abroad to use the official channels for their financial services.

8.2.3 Comprehensive recovery framework

Commercial banks should also establish a comprehensive recovery framework, approved by the CBoS, which should:

1. Reduce the probability and impact of failure of important banks by developing a recovery and resolution framework, based on international good practice.
2. Intervene to address weak and failing banks early to minimize the impact.
3. Design a set of procedures and guiding principles regarding the provision of public assistance and the necessary safeguards for troubled banks.
4. Maintain common risk standards and develop guidance on loan restructuring and risk management policies to ensure that regulatory forbearance measures can be fairly applied.

8.2.4 Establish and implement recapitalization strategy

Increase capital adequacy of banks against the market and operational risks per Basel II guidelines.

8.2.5 Address state-owned bank board and senior management issues

1. Apply the Company Act of 1925 to the nomination and appointment of bank boards.
2. Ministry of Finance and Economic Planning, and Social Security Fund can name board members, however, CBoS staff should not be part of the board or senior management of any bank.

3. All board and senior management of banks should be approved by CBoS to ensure they have relevant skills and experience and meet the requirements for bank boards.

8.3 Digital financial services and fintech

The next government will have a huge opportunity to utilize digital financial services (DFS) to digitize the economy and bring financial services to the vast majority of the population who are currently excluded from them. The development of digital financial services requires improvements in regulations and infrastructure. Opening digital services markets to the private sector, especially fintech, as they constitute a driver for competition and innovation, is vital. Fintech has the potential to disrupt and evolve financial markets, as well as act as an enabler of financial inclusion in Sudan by expanding access to financial services while reducing costs to serve unbanked people.

8.3.1 Market data

There were **32.83 million** mobile connections in Sudan in January 2020, having **increased** by **2.3 million** (+7.4%) since January 2019 and equivalent to **76%** of the total population at that time.[44] Some additional data:

Total Population (June 2021)	**44,909,351.00**
Potential Consumers	33,923,000.00
Smart Phones	17,380,000.00
All Phone SIM cards	32,830,000.00
Current Banked Customers	5,658,450.00
Banks	39.00
Telecom	4.00
Licensed fintech	64.00
Current POS	36,380.00
Labor Force	11,517,982.00
Digital payments users	2,863,380.00
Mobile agent outlets	11,000.00
GDP 2020 (Billion $)	$26.11

8.3.2 Opportunities

Digital financial services offer wide-ranging opportunities, since it holds the promise of reducing costs and friction, increasing efficiency and competition, narrowing information asymmetry, and broadening access to financial services, especially in low-income areas and for underserved populations although the benefits of technological changes may take time to fully materialize. Ongoing innovations and technological advances support broader economic development and inclusive growth, facilitate international payments and remittances, and simplify and strengthen regulatory compliance and supervisory processes. Digital financial services (DFS) provide an excellent channel for international remittances, an important source of income for the poor. In 2021, the volume of cross-border

[44] Digital 2020: Sudan https://datareportal.com/reports/digital-2020-sudan

remittances to developing countries had surpassed foreign direct investment and was estimated to reach USD 589 billion.[45]

8.3.3 Risks

Introducing digital financial services will come with potential risks posed to the banking system and to its customers. As the financial system adapts, concerns arise regarding a range of issues, including:

1- Consumer and investor protection.
2- The clarity and consistency of regulatory and legal frameworks to support the new business models and the new digital financial services.
3- The adequacy of existing financial safety nets, including lender-of-last-resort functions of central banks.
4- Potential threats to financial integrity.

Moreover, the adoption process may also pose transition challenges, and policy vigilance will be needed to make economies resilient and inclusive, so as to capture the full benefits.

8.3.4 Challenges

To overcome the digital services adoption challenges, it is important for CBoS to be nimble, innovative, and cooperative and importantly will need to strike the right balance between enabling financial innovation on the one hand and addressing challenges to market and financial integrity, consumer protection, and financial stability on the other. This balance is critical to deliver the welfare benefits of financial innovation and avoid stalling the development of fintech with the risk of leaving the underserved behind.

Fintech companies who spearhead providing digital financial services face a broad range of challenges from economic, competitive, institutional, and technological forces, including:

1. **Economic:** Investing in digital services and highly skilled knowledge workers is growing rapidly.
2. **Technological:** Technology is changing rapidly, especially in providing digital services.
3. **Market:** In an underdeveloped market like Sudan, Fintech will face immense pressure to seek new ways to acquire new markets and meet customers' needs. Opening digital financial services for fintech and telco will create tougher competition in the fintech market. Also, spread in communications and social media can create a consumer base that will require excellent services when and where they need them.
4. **Institutional:** Accountability for effectiveness and efficiency should be demanded by fintech stakeholders as well as customers to lead. Tough security requirements and international regulations should lay out standards which every digital services provider should meet.

8.3.5 Fintech Recommendations

The CBoS should develop a strategy or roadmap to help guide it in promoting digital financial services and fintech and spearhead the promotion of financial, social, and economic inclusion. Some of the main steps in the roadmap to support digital services include:

[45] Remittance Flows Register Robust 7.3 Percent Growth in 2021 https://www.worldbank.org/en/news/press-release/2021/11/17/remittance-flows-register-robust-7-3-percent-growth-in-2021

1. **Embrace the promise of fintech by reaping the full benefits of digital services through adequate preparation including:**
    - **a.** Strengthening of fintech institutional capacity.
    - b. Recruiting of relevant expertise in the CBoS to provide the right oversight and supervision for fintech.
    - c. Improvement of external communication with all stakeholders.
    - d. Expansion of consumer education.
2. **Enable new technologies to enhance financial service provision by:**
    - a. Facilitating foundational infrastructures, fostering their open and affordable access, and ensuring conducive policy infrastructures including telecommunications, along with digital and financial infrastructures.
    - b. Developing access to telecommunications, and mobile data services including Unstructured Supplementary Service Data (USSD) channel to all digital services providers.
    - c. Pushing for digitizing the entire economy and enabling stakeholders to access relevant data.
    - d. Working with other stakeholders to develop a digital identity mechanism to reliably authenticate customers.
    - e. Developing financial infrastructures for cross-border payments.
3. **Reinforce competition and commitment to open, free, and contestable markets** to ensure a level playing field and to promote innovation, consumer choice, and access to high-quality financial services. To do this:
    - a. The CBoS should address the risks of market concentration, monopoly and should foster standardization, interoperability, and fair-and-transparent access to key infrastructures.
    - b. Require banks to provide secure access to financial services from any channel that the customer may choose (Consumers must have control over their accounts).
    - c. Leverage fintech capacity to lower barriers to entry for non-traditional players, including through adapting laws and regulations, while maintaining competition.
    - d. Adapt competition policy frameworks for fintech and their new business models.
    - e. Develop best practices for similar activities and risks.
    - f. Promote new ways to raise funding for fintech.
4. **Adapt regulatory frameworks and supervisory practices for the orderly development and stability of the financial system** and facilitate the safe entry of new products, activities, and intermediaries; sustain trust and confidence; and respond to risks.
    - a. Supplement the current regulatory approaches to address digital services-driven changes.
    - b. Regularly review, analyze, and mitigate risks that may result in the financial landscape and impact financial stability.
    - c. Utilize technological advances to support the efficiency and effectiveness of regulation.
    - d. CBoS and other regulatory authorities should keep up with challenging market developments. They will need to ensure that the knowledge and skills of staff and the tools available to them remain effective in supervising innovative business models (additional training, recruitment of specialized staff).
    - e. Modification and adaptation of regulatory frameworks to contain risks of digital services, while recognizing that regulation should remain proportionate to the risks.
5. **Safeguard against the misuse of the digital services.**
    - a. Identify, understand, and assess the risks of digital financial services, especially in relation to ML/TF, and mitigate them by applying the correct measures including appropriate AML/CFT.
        - i. Encourage digital services and products that strengthen the AML/CFT framework.
        - ii. Promote developing digital solutions that could facilitate AML/CFT compliance.
    - b. Develop institutional capacity and communication with digital financial services providers.

   c. Utilize technologies that strengthen compliance with anti-money laundering and combating the financing of terrorism (AML/CFT) measures.
   d. Strengthen AML/CFT compliance and monitoring, including by using technology to support regulatory compliance and supervision.
   e. Identify digital services applications that may pose new threats to financial integrity and mitigate the risk.
   f. Review and update the regulations benefiting from international best practices to address the decentralized and global nature of digital financial services.
6. **Modernize legal frameworks** to provide an enabling legal landscape with greater legal clarity and certainty regarding key aspects of fintech activities.
   a. Develop and modernize legal frameworks that support trust and reliability in financial products and services. Sound legal frameworks support the evolution of the financial system by providing a foundation of stability, predictability, and harmonization across domains and different jurisdictions.
   b. Ensure the legal framework has clear and predictable legal rules that accommodate technological change, tailored to national circumstances, particularly in areas such as contracts, data ownership, insolvency, resolution, and payments.
7. **Promote the development of robust financial and data infrastructure** to sustain digital services benefits that are resilient to disruptions including cyber-attacks and that support trust and confidence in the financial system by protecting the integrity of data and financial services.
8. **Define a framework to address all the issues and challenges** that are relevant not only to the financial sector but also to the digital economy at large that may arise, including data ownership, protection, and privacy, cybersecurity, operational and concentration risks, and consumer protection.
   a. Define a robust financial and data infrastructure is necessary to provide operational resilience, preserve confidence, and rapidly recover from disruptions such as cyber-attacks.
   b. Enhance cybersecurity to protect the digitalization of finance. It must be fully integrated into the development of new processes from the start.
   c. Ensure individual and institutional data is well protected by strong frameworks.
9. **Encourage international cooperation and information-sharing** across global digital services stakeholders to share knowledge, experience, and best practices to support an effective implementation framework. The new government can support international collaboration, leveraging the partnership with international institutions by:
   a. Sharing views and the private sector on digital services developments.
   b. Monitoring the increased interconnectedness of financial systems and enhancing communication across countries.
   c. Adapting policy responses to reflect the evolution of the financial system.
   d. Monitoring global market developments and emerging issues and risks to ensure the adequacy of the regulatory environment.
   e. Building technical and regulatory capacities by participating in international training and peer-learning programs.
10. **Enhance the development of policies to support inclusive global growth,** poverty alleviation, and international financial stability. Some of the key policy objectives are:
    a. Promoting inclusive growth, access to financial services, and financial stability.
    b. Examining the growing blurring of boundaries of international flows.
    c. Enhancing the quality of the legal, regulatory, and supervisory framework.
    d. Improving the capacity to manage and resolve financial crises.
11. **Promote and strengthen interoperability** - Systems are increasingly talking to other systems, thereby creating seamless access to information. Customers demand services from anywhere on demand. Data can more readily be integrated into commonly used communication networks and systems, and in a cost-effective manner due to advances in fiber optics and other technological advances.
12. **Focus on digital solutions that address climate change** resilience and adaptions.

8.4 Enhancing Banking Resilience During Wartime: Key Recommendations

8.4.1 Tackling Operational challenges

The centralization of banking operations in Khartoum and heavy dependence on headquarters, most of which are now in a war zone, can severely impact the functioning of branches located in other states. Here are some considerations for managing this situation:

1. Disaster recovery locations (DR): Building disaster recovery locations (DR) which allow banks to function properly even if the main site is not functioning.
2. Decentralization or loosely coupling operations: Decentralizing banking operations can help ensure the continued provision of services in other states. This could involve establishing regional or local hubs that have the necessary infrastructure and resources to operate independently, even if headquarters face disruptions. Distributing essential functions and decision-making capabilities across locations could both allow banks to resume functions quickly in the short term and be further developed to enhance the resilience of the banking system in the future.
3. Strengthening branch capacities: Providing support and resources to bank branches operating in regions less affected by the war can help mitigate the impact of centralized operations in Khartoum. Ensuring these branches have sufficient staffing, access to technology, and necessary training can enable them to maintain essential banking services locally, minimizing disruptions for customers.
4. Mobile and digital banking: Promoting the use of mobile and digital banking services can help bridge the gap caused by centralized operations. Encouraging customers to adopt digital banking platforms and expanding their availability can provide alternative channels for banking transactions, reducing the reliance on physical branches and the headquarters in Khartoum.
5. Collaborations and partnerships: Exploring collaborations with other financial institutions, including local banks or international counterparts, can provide temporary solutions for customers in regions affected by the war. Partnering with institutions that have operational capacity outside the war zone can facilitate the continuation of banking services and ensure uninterrupted access to financial services.
6. Government support: Engaging with the current government to address the challenges faced by the banking industry in the war zone is crucial. This could include advocating for measures such as enhanced security for bank branches, prioritized access to resources, and support for the decentralization of operations.
7. Crisis management and business continuity planning: The CBoS should develop guidelines for the development by banks of robust crisis management and business continuity plans specific to the war zone. Implementing measures to ensure the safety of employees and the protection of assets, as well as to establish alternative communication channels and backup systems, can help banks navigate the challenges and maintain essential operations.
8. The centralization of banking operations in a war zone presents significant challenges, but with strategic planning, collaboration, and government support, banks can work towards ensuring the continuity of services and support for their customers in other regions.

8.4.2 Payment systems and electronic payments

The lack of effective business continuity plans in the banking sector, coupled with the closure of banks in Khartoum and the failure of digital financial services, has resulted in significant challenges for customers and service providers. The centralized nature of the banking system and the dependence on key systems operated by CBoS and EBS further exacerbate the situation. Here are some considerations for addressing these challenges:

a. **Urgent restoration of systems:** Prioritizing the restoration of critical systems operated by CBoS and EBS is crucial to resume digital financial services. Efforts should be made to gain access to data centers, ensure stable connectivity and secure power supply to enable these systems to operate effectively. Collaborating with relevant authorities, internet service providers, and power supply agencies can help address these infrastructure challenges.
b. **Collaboration with private switches:** Banks with private switches make more effort to provide services since they can do that independently of EBS, similar to the Bank of Khartoum, which has managed to bring its systems intermittently online, to provide digital services to their customers. Sharing resources, knowledge, and expertise can help other banks gradually restore their digital services and provide access to customer accounts.
c. **Support for fintech and digital service providers:** Recognizing the importance of fintech and digital service providers, it is crucial that the government extend support to them during this challenging period. Collaborating with these providers to explore alternative solutions, temporary infrastructure setups, or even utilizing their platforms and capabilities can help restore digital financial services for customers.
d. **Government intervention:** The government should actively intervene to address the challenges faced by the banking sector and digital service providers. This could involve providing support for infrastructure restoration, ensuring stable power supply and fuel availability, and creating an enabling regulatory environment to expedite the recovery of digital financial services.
e. **Learning from experience:** The current situation highlights the need for robust business continuity plans in the banking sector and digital financial service providers. It is crucial to learn from this experience and invest in building resilient systems, redundant infrastructure, and alternative connectivity options to minimize future disruptions.