



## Effectiveness of Bank of Ghana's regulation and supervision of banks in Ghana

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### Abstract

Several crises have hit banks and financial institutions, the most widespread being the 2007/8 World Financial Crisis which has signaled the need for effective regulation and supervision of banks and the financial sector. This study seeks to investigate the impact of regulation and supervision of banks by the Bank of Ghana (BoG). The research largely uses survey method involving a cross-sectional study of selected commercial banks and customers, and selected officials of the Banking Supervision Department (BSD). The SPSS was employed in data processing and analysis. The study has revealed that BSD has the appropriate resources: adequate and knowledgeable staff and financial resources, and is well equipped to handle potential crises. But a critical challenge is the need to upgrade the outmoded off-site monitoring device (EFASS System) to enhance efficiency and effectiveness, and lack of appropriate IT resources, mostly software related, all calling for urgent attention.

**Keywords:** regulation and supervision; banking supervision department; Bank of Ghana; financial environment; commercial banks.

### INTRODUCTION

Several forms of regulation have been instituted in many countries including Ghana to protect the financial environment from illegal dealings and transactions. Various aspects have been concerned with consumer protection in connection with financial services, the encouragement of small investors, capital adequacy requirements, the ability of small firms to obtain venture capital, or protecting market reputation and the practitioners in it.

Major financial scandals involving international banks like the Allied Irish Banks, the Bank of Commerce and Credit International (BCCI) and Daiwa Bank have been experienced. Banks like Bank for Housing and Construction (BHC), Ghana Co-operative Bank (GH CO-OP), BCCI and Meridian BIAO have also been hit by such crises and have collapsed. In all these cases, jobs were lost, shareholders became worse off, and employees and customers lost their savings. These resulted in loss of confidence in the equities and other financial products as well as the financial markets. A most recent occurrence of such a scandal which has taken an international dimension is the World Financial crisis of 2007/8 (Salami and Lambert, 2012).

What appears to be on most people's minds is whether such scandals could not have been prevented. It is one of the responsibilities of Bank of Ghana (BoG) to ensure that such related crises are at least mitigated if not prevented entirely. This then brings us to the importance of effective prudential regulation and supervision by a supra national authority such as the BoG in forestalling the likelihood of occurrence of such crises and scandals. Our study therefore seeks to

investigate the effectiveness of BoG's regulation and supervision of banks in Ghana.

The specific objectives of the study include the following:

- investigate the existence of adequate regulation for effective supervision of banks in Ghana;
- ascertain if the BoG is well resourced to effectively ensure the efficient operation of banks in Ghana;
- investigate the challenges facing the BoG in relation to supervision of banks;
- put forward policy recommendations for enhancement of the effectiveness of regulation and supervision of banks.

This study is of significance to a number of beneficiaries. The study will enhance the knowledge of the researcher in the area. It will educate the banking public about the importance of banks supervision, and the need for supervised banks to co-operate with regulators and supervisors. It will add to the existing literature on the topic of bank regulation and supervision. BoG and other banks and financial institutions being supervised will also derive substantial benefits. The study will act as important reference document for academia.

A study of this nature will not be free from certain limitations. Majority of the information for analysis will be based on limited information obtained through sampling of the target population, and this is often characterized by statistical errors that may limit the significance of the findings of the study.

Apart from the introductory section, the remainder of the study is structured as follows: Section 2 will examine the existing relevant literature on the study, while section 3 considers the methodology of the study. Section 4 deals with the analysis of results and discussion of the processed data. The last section looks at the conclusions and recommendations of the study

## REVIEW OF LITERATURE

Bank failures may wipe out household savings and restrict a firm's access to credit. Similarly, failure or collapse of financial institutions may create doubts in the minds of savers about the stability and solvency of financial institutions and the financial system. Financial institutions including banks must therefore be effectively regulated and supervised to prevent these types of market failure and the attendant costs to the economy (Saunders and Cornett, 2009).

Apea and Sezibera (2003) have commented on bank failures and attendant costs implication. Among the several causes identified was the major problem with supervision of banking activities. Researchers like Mishkin and Eakins (2009) and Howells and Bain (2007) have identified potential problems of banks supervision despite the existence of varied regulations to support it. Several bank failures and related effects have been reported by researchers like Lau (2002), Salami (2002), Howells and Bain (2007), and Madura (2010). Among some of the effects reported were panic withdrawal of funds, problems of illiquidity, loss of jobs, investment and equities of shareholders, insolvency problems, contagion effects and ultimate erosion of confidence in the financial system.

On an operational definition of regulation and supervision the works of Lyade (2006), Salami (2002) and Rolland (2011) are significant. Lyade (2006) has identified four approaches to banking regulation as information disclosure; self regulation using internal and external audit and control committee of the board; on-site and off-site examination; and deposit insurance scheme that helps to protect depositors' funds against losses. Salami (2002) indicated a number of common threads that appear to run through prudential regulation as: the need for authorization; supervision including inspecting and reporting to ensure regulation compliance; compensation arrangements for private individuals when businesses fail. Rolland (2011) identified the core elements of bank regulation as: supervision; setting reserve requirements; acting as lender of last resort; and ensuring the supply of deposit insurance. Generally, these researchers are agreed on the definition of regulation and supervision of banks.

A number of arguments have been put forward for and against regulation and supervision. One positive view is that it is the ideal and effective way to protect bank depositors from the effects of bank failures. Another positive reason is that of the notion of market failure and political sensitivity of financial services (Howells and Bain, 2007). On arguments against regulation, issues of moral hazard, agency capture, creation of compliance costs, and tendency to preserve monopoly resulting from the need to comply with regulations and related cost increases of entry into and exit from markets, have been well captured by Howells and Bain (2007).

Of late a notable development among banks is the widespread usage of advanced information and communication technologies which have given rise to varied information technology-related risks in banking and call for adoption of appropriate software technologies to mitigate the likelihood of occurrence of bank failures (Dosoo, 2006); Amissah-Arthur (2011). On such general difficulties faced by bank regulators and supervisors, Mishkin and Eakins (2009) have concluded that banks must set up appropriate structures and employ necessary controls and tools to operate and mitigate the associated risks to be able to reduce the possibility of bank failures.

Madura (2010) has written on difficulties associated with regulation of international banks, while Mishkin and Eakins (2009) are of the view that what is necessary is cooperation among regulators in different countries together with

standardization of regulatory requirements which come under the control of Bank for International Settlements (BIS, 2011)

In Ghana, it is the Bank of Ghana (BOG) that is charged with the banks regulatory and supervisory function. BOG (2012) stipulates that it shall have overall supervisory and regulatory authority in all matters relating to banking and non-banking financial business to achieve a sound and efficient banking system in the interest of depositors and other customers of financial institutions and the economy as a whole. The regulatory and legal framework within which banks, non-bank financial institutions as well as forex bureaux operate in Ghana consists of: the Bank of Ghana Act 2002 (Act 612), Banking Act, 2004 (Act 673) Financial Institutions (Non-Bank) Law 1993, PNDC Law 328, Companies Code (Act 179, 1963), and Bank of Ghana Notices / Directives / Circulars / Regulations.

The BoG as a regulator, has several objectives including the following:

- regulate, supervise and direct the banking and credit system;
- ensure the smooth operation of a safe and sound banking system;
- appoint an officer designated as the head of Banking Supervision Department, who shall be appointed by the Board; and
- consider and propose reforms of the laws relating to banking business.

These objectives should ensure that BOG exercises its mandate to ensure the safety of depositors' funds; maintenance of the solvency of banks; good quality assets; adequate liquidity and profitability; enforcement of adherence to statutory and regulatory requirements; fair competition among banks; and maintenance of an efficient payment system.

Enhancement of the legal and regulatory framework means that the BOG's regulatory and supervisory functions are designed to be consistent with the Basle Core Principles for effective banking supervision (BOG, 2012). The number of Deposit Money Banks (DMB) was 26 at the end of December 2010, of which 50% were foreign-owned. Rural and Community Banks (RCB's) numbered 135 during the same period, and all these banks operated under BoG's regulation and supervision.

## METHODOLOGY

A cross-section survey method was mainly used for this study. The importance and benefits of survey research are well documented in Moser and Kalton (1986). In selecting our samples for primary data collection, a non-probability sampling method, specifically, convenience sampling technique, was used to arrive at the number of officials of BoG, that is, the Banking Supervision Department (BSD); a sample of commercial banks; and a list of bank depositors (customers). According to Saunders, Thornhill and Lewis (2006), convenience sampling involves selection of those cases that are easier to obtain for one's sample. It is widely used but its serious disadvantage is that it is prone to bias and influences that are beyond the control of the researcher, and these must be borne in mind in the conduct of such related survey research.

The location of the study is Accra, the capital city of Ghana. It represents relatively the most advanced and sophisticated financial and commercial centre in Ghana. All major financial institutions, including banks, are concentrated in Accra with their head offices and therefore offers a natural choice of location for the study.

For the purposes of the study, 3 BSD officials; 12 commercial banks; and 15 bank depositors (customers) were decided on for interview administration to solicit relevant information that would enable attainment of the original objectives of the study. Three types of questionnaire were therefore designed for the above three sample groups: BSD; commercial banks; and bank depositors, with the study objectives in mind. Issues like monitoring role of BSD and its effectiveness; resourcefulness of BoG for regulation and supervision roles; commercial banks' opinion about operations of BSD; relationships between BSD and commercial banks; relationships between commercial and bank customers; availability of resources, (human, material, technological, etc) to these three groups of samples, etc were all considered as pertinent issues in the design of the three types of questionnaire so as to reveal all relevant and salient factors critical in the attainment of the original objectives of the study.

All the three groups of sample were interviewed during the months from August to November 2012 using the three questionnaire types designed for the purpose to solicit relevant information from selected respondents. To maximize time usage, all questionnaires were self-administered (Saunders, et al, 2006). The Statistical Package for the Social Sciences (SPSS) was used to process the data to produce results in the form of tables, figures, percentages and other descriptive statistics that would aid easy analysis in the next stage of the study.

The primary data collection sources were supplemented by secondary information obtained from the audited accounts and annual reports as well as statutory returns of banks submitted to BOG, various reports of the BSD such as reports on trends and relevant progress reports of banks, BoG Annual Reports etc., and other relevant literature from BoG.

**Table 1.** Banking Regulations

Questions	Responses (%)		
	Agree	Disagree	Total
• The Banking Act and the Companies' Code provide BoG with the necessary legal backing to carry out its mandate of banks supervision.	100		100
• Penalties for non-compliance with capital, liquidity and other requirements under the Banking Act have ensured stability in the banking system in Ghana.	33.3	66.7	100
• Effective regulation/supervision by BSD backed by relevant legislation focuses attention on protecting customers' interest.	100		100

Source: Survey Data ( 2012)

## ANALYSIS OF RESULTS AND DISCUSSION

The analysis of the study is with respect to the three sample groups identified in our methodology section, namely BSD; supervised commercial banks; and bank depositors (customers).

### Banking Supervision Department (BSD)

BSD is responsible for ensuring banks' compliance with all banking regulations so that depositors' funds are properly managed and kept safe by the various banking institutions to forestall the possibility of any illegal dealings within and among banks. A number of related issues for analysis are provided below.

### Banking Regulations

Table 1 illustrates the responses of selected BSD staff with respect to banking regulations and effects on their operations.

All the respondents affirmed that the Banking Act (Banking Act, 2004, Act 673, together with the Banking Amendment Act 2007, Act 738, and the Companies' Code, 1963, Act 179, provide BoG with the necessary legal backing to carry out its mandate of banking supervision. Besides, the respondents were in agreement that, the BSD backed by the relevant legislation focused attention on protecting customers' interest. But 67% of the respondents were not in agreement that penalties for non-compliance with capital, liquidity and other requirements under the Banking Act were adequate. As to whether certain sections of the Banking Act needed to be reviewed, an official of the BSD suggested in the affirmative and explained further that the Act was under review with respect to enforcement of penalties. Currently, enforcement of the penalties prescribed by the Banking Act is by the courts, which could unduly slow the regulatory system.

### Resourcefulness of BOG for Regulation/Supervision

Table 2 illustrates that the BSD mostly possesses adequate resources to perform their regulatory and supervisory functions, with the exception of computer-based software resources. This fact appears to confirm the position of Madura (2010) that one great challenge facing many regulators/supervisors is the availability of appropriate resources to carry out their operations effectively.

Table 2 appears to imply that BSD has the appropriate resources in terms of adequate and knowledgeable staff and financial resources to carry out their mandate. But the critical constraint facing the BSD as confirmed by 67% of respondents was lack of right and appropriate computer-based monitoring software, especially for off-site monitoring tasks and operations.

What Table 3 appears to illustrate is that majority of respondents were in agreement that BSD was well equipped to handle potential crises meaning that BSD could foresee when a bank was heading for a run down so that appropriate

**Table 2:** Resources of the BSD for regulation of banks

Resources	Response (%)		
	Yes	No	Total
Knowledgeable Staff	100		100
Finances	100		100
Adequate Number of staff	100		100
Appropriate Software	33.3	66.7	100

Source: Survey Data (2012)

**Table 3.** Resources of BSD for Supervising Banks

Questions	Responses (%)		Total
	Yes	No	
• Available resources are sufficient for effective operations of the BSD.	66.7	33.3	100
• BSD's resources are adequate enough to allow for on-site inspection of all the banks within a calendar year	100		100
• BSD is well equipped to handle potential crises, thus BSD can foresee when a bank is heading for failure and take steps to get the situation under control	66.7	33.3	100

Source: Survey data (2012)

steps could be initiated to remedy or safe the situation.

A recent incident involving a merger between Ecobank and Trust Bank in 2012 under a new merger name, Ecobank Ghana Ltd, with the support of BoG, appears to confirm this. Another illustration is that since 2004 no incident of bank failures has taken place in Ghana. The works of Apea and Sezibera (2003) seem to recognize this fact concerning the importance of proper supervision of banking activities.

### Operations of BSD

Table 4 illustrates that licenced commercial banks readily provide any information requested by BSD during on -site supervision. This appears to confirm the importance of one of the conditions for effective prudential regulation in an effort to forestall the potential of bank failures (Salami, 2002)

### Challenges confronting BSD in its Operations

In depth investigation through contacts with relevant officials into BSD operations has revealed that critical challenges confront BSD, a fact acknowledged by Mishkin and Eakins (2009) that challenges faced by regulators/supervisors like adequate resources or expertise to keep up with 'clever' people in financial institutions can drive related institutions into difficulties. Several among these challenges are:

- The need to upgrade the outmoded EFASS System (used in off-site monitoring supervision) to enhance efficiency and effectiveness of the off-site monitoring mechanism.
- The need for computer software to interrogate the system of banks to have an in-depth knowledge of their activities.
- The need for improvement in skills of risk-based Supervision.



**Table 4:** Readiness of Commercial Banks to comply with regulations

Questions	Responses (%)		
	Disagree	Agree	Total
• Commercial Banks readily supply relevant information required by BSD during on-site supervision		100	100
• BOG's authority to inspect institutions suspected to be operating banking business without holding a valid licence has eliminated unauthorized banking business in the country.	33.3	66.7	100

**Source:** Survey Data (2012)

- Lack of staff with requisite skills for regulation/supervision of banking products such as derivatives, SWAPs, Options, treasury operations etc.
- Lacking in capacity to handle ICT products introduced by the banks.

### Supervision of International Banks

Our investigation through interviews with relevant officials and other secondary data sources appear to confirm the position of Mishkin and Eakins (2009) that co-operation among regulators in different countries together with standardisation of regulatory requirements, could provide potential solutions to the problems of regulating international banking, which seems to be a problem area for modern day banking business. For example, the May 2011 IMF Financial Stability Assessment on Ghana, indicated that 'BOG has been making efforts to align its regulatory/supervisory framework with international standards, but there still remain important gaps'. The report expressed that despite major accomplishments on the legislative front and the efforts to strengthen supervision, the level of non-compliance with Basel Core Principles was high; enforcement of prudential regulations was also found to be weak. In this regard, Mishkin and Eakins (2009) and Rolland (2011) have identified the Basel Accord (Basel I and II) to be the frameworks for national legislators, and consider it as the standard for their domestic legislation. Our interview with BSD officials has confirmed that BSD has difficulties with full compliance with the Basel Accords and that it is yet to implement Basel II and III. In the estimation of BSD, implementation of the Basel Accords will enhance the safety and soundness of Ghana's banking system. Related recommendations flowing from the IMF Country Report (2011) were:

- address the deficiencies identified in risk management regulations, supervisory response times, and cross-border supervision;
- some risks in the banking system, such as interest rate risk and information technology (IT) and operational risk, will need to be properly addressed and in-house expertise will need to be developed;
- the planned adoption of the standardized approach of the Basel II framework should not proceed without meeting certain pre-conditions. The transition to Basel II will require sound project management by the BOG, including extensive technical analysis and some policy decisions.

Apart from these, others suggested for immediate implementation to strengthen banking supervision included:

- amend the Banking Act to comprehensively address all identified regulatory gaps that undermine the BOG's operational independence, supervisory and enforcement powers, including revoking the provision to appeal to the minister;
- empower the BOG undertake consolidated supervision; and increasing capital threshold for revoking the license;
- strengthen licensing procedures to ensure that only sound and healthy banks with "supervisable" structures or strong home supervisors enter the market;
- establish guidelines to enhance risk management in the industry; and
- Strengthen supervisory processes and capacity to ensure effective risk-based supervision.

What the above appear to indicate is that all is not rosy with BSD, and that positive efforts must be mobilised to address the areas identified to able to forestall potential problems that can court bank failures.

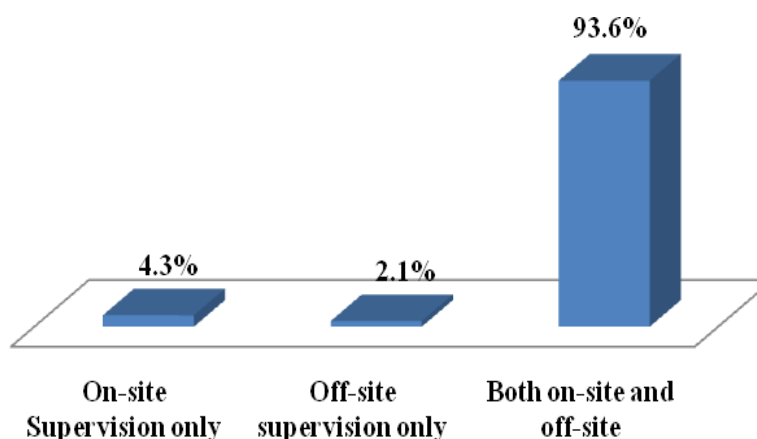
### Commercial Banks

The Banking Act empowers BoG to inspect and supervise commercial banks. These powers are exercised through on-site and off-site surveillance. To ascertain how the banks perceive the effectiveness of the supervisory role of BOG, a

**Table 5.** Banks' perception of the effectiveness of BSD's supervision

Questions	Responses (Frequency)		
	Agree	Disagree	Total
• The Supervisory framework of banks is very effective in the Ghanaian banking system.	47	3	47
• The Stability in the banking system is the result of sound and effective supervisory and regulatory framework of banks.	41	6	47
• The performance rating of BOG in controlling banks' activities is very high.	35	12	47
• Regulation/supervision of banks has helped in protecting depositors' funds by restricting certain banking activities and minimizing bank losses through compliance with the Banking Act.	44	3	47

Source: Survey Data (2012)



**Figure 1:** Preference of method of supervision of banks

Source: Survey Data (2012)

set of questionnaires was given to a selected number of commercial banks to assess their opinions.

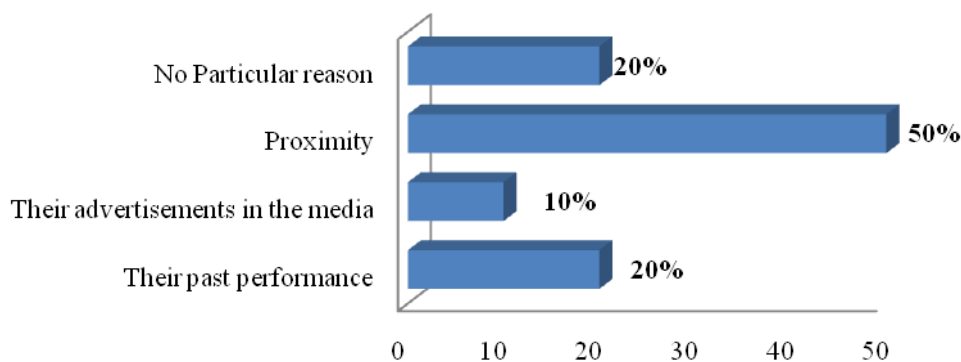
### Perception by Commercial Banks on the Effectiveness of Supervision

Table 5 above indicates that 44 out of the 47 respondents agreed that the supervisory framework of banks within Ghana's banking industry is very effective and majority are convinced that supervision has resulted in the stability of the banking system and have rated the performance of BOG very highly and has helped to minimise bank losses and protect depositors funds, a fact which appears to confirm the positions of Rolland (2011) and Iyade (2006).

Figure 1 illustrates that about 94% of respondents appear to prefer both the On-site and Off-site methods of supervision which also appear to confirm Iyade's (2006) stand.

In the light of the analysis of issues concerning banks supervision, respondent banks have made the following suggestions which could further enhance the efficiency of BoG's regulatory and supervisory role:

- BOG should offer advice and corrective measures instead of applying penalties and sanctions;
- BOG should engage more supervisory staff with commercial banking background;
- BSD must ensure that examiners are knowledgeable in the particular areas of examination;
- BSD should improve upon the time it takes to respond to concerns from banks;
- BOG should be vigilant on the enforcement of the Foreign Exchange Act 2006 Act 723 in particular.



**Figure 2:** Reasons for Choice of Banks by Depositors  
**Source:** Survey Data (2012)

## Depositors (bank customers)

### Importance of knowledge of bank customers of information

Effective supervision has direct impact on the banks' customers and their funds, so an investigation was conducted to examine the extent of their knowledge about the supervisory role of BoG and safety of their funds.

Figure 2 above illustrates that majority saved with banks because of proximity (50% of sample); bank's past performance (20% of sample), and media advertisements (10% of sample) all of which are important knowledge factors to consider. This fact appears to confirm the position of Salami (2002) whose view is that savers should have access to information they need to form proper judgement about the prospects and risks attached to the securities they purchase, and that dealing in financial markets is fair.

Table 6 further provides an indication of the importance of knowledge of banks customers and impact on choice of banks. The table illustrates that majority are of the opinion that information disclosure by banks helps them to develop a positive view and better understanding of their banks.

### Awareness of BOG's Supervisory Function by Depositors

Table 7 highlights level of awareness by bank customers of BSD's supervisory function. 80% of the respondents are convinced that the supervisory function of BOG ensures safety of their funds. This is contrary to the argument by Howells and Bain (2007) that regulation might create the tendency for moral hazard. Furthermore 90% of the respondents are convinced that the stability of the banking system is the result of sound and effective regulatory/supervisory framework of banks.

The view of about 80% of the respondents is that effective supervision by BoG has reduced the rate of bank failure in Ghana and has encouraged banks to provide quality services for their customers and promoted an efficient and competitive banking system. However, public knowledge or awareness of BOG's operations with regard to withdrawing the license of non-performing banks is scanty and minimal, according to 70% of the respondents, illustrated in Table 8.

## CONCLUSIONS AND RECOMMENDATIONS

### CONCLUSIONS

One of the important conclusions of the study is that BSD has the appropriate resources in terms of adequate and knowledgeable staff and finance, but is lacking in monitoring software, a critical limitation on effectiveness of the Off-site supervisory monitoring role. Secondly, the view of majority is that BSD is well equipped to respond to potential crises as it could make a prediction with respect to a bank facing imminent crisis, and thereby take necessary and appropriate steps to forestall its occurrence. Another revelation is that the commercial banks duly comply with both the On-site and the Off-site regulations of the BSD. But there are few challenges, mostly ICT-related that appear to threaten the effectiveness of BSD's operations. The most critical of these relates to the outmoded EFASS System that tends to constrain the effectiveness of BSD's Off-site monitoring system. Another conclusion is that effective operations of BSD



**Table 7.** Awareness of Supervisory Function of BOG by Depositors

Questions	Response (%)		
	Agree	Disagree	Total
• As a bank's customer, I am convinced that the supervisory function of BOG ensures safety of my deposits	80	20	100
• I do not have worry about the performance of my bankers because the supervisory functions of BOG would ensure that my funds are secured.	40	60	100
• I am aware that I can do a background check on any bank at BOG before I decide to do business with them.	70	30	100
• The stability of the banking system is the result of sound and effective regulatory and supervisory framework of banks.	90	10	100
• Regulation/supervision of banks by BOG have helped in protecting depositors funds by restricting certain banking activities and minimizing bank losses through banks' compliance with the banking act.	80	20	100

**Source:** Survey Data (2012)

**Table 8.** Awareness of banks customers on the effectiveness of Regulation/Supervision

Questions	Response		
	Agree	Disagree	Total
• Effective regulation and supervision of the Banking system by BOG has gone a long way to reduce the rate of bank failure in Ghana	80	20	100
• Effective banking regulation and supervision by Bank of Ghana encourages banks to provide quality services for their customers and promotes an efficient and competitive banking system	80	20	100
• Public awareness of the authority of the Bank of Ghana to withdraw non performing banks' licenses is high	30	70	100

**Source:** Survey Data (2012)

has brought about positive impact on the general performance of commercial banks. It has also been revealed by majority (80%) of the sample that effective supervision of banks by BSD has reduced the rate of bank failure in Ghana and has encouraged banks to provide quality services for their customers and also promoted an efficient and competitive banking system. However, there is low and limited public knowledge or awareness of BOG's operations with regard to withdrawing the license of non performing banks.

## RECOMMENDATIONS

The foregoing analysis has resulted in some important recommendations, one of which is that BSD should recruit more staff with commercial banks experience, especially relevant IT-related staff; provide continuous on-the-job and off-the-job training to benefit existing staff in response to the complex and sophisticated demands of modern day banking. BSD

should also invest in relevant and necessary software that can be used to interrogate the system of banks being supervised to be able to obtain an in-depth knowledge of the activities of these banks. Lastly, it is important that BSD implements the recommendations by the IMF Report, especially, with respect to the Basel Accord, as it will help to enhance the stability of the banking system and its relationship with its international counterparts, especially as the world has become a global village.

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