



Position Paper:

The Banking Industry... More Fragmentation and Isolation

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Table of Contents:

Preface	4
The Current Status Quo and the Stances of the Parties!	6
■ The CBY in Aden	7
■ The Central Bank in Sana'a	9
■ The Saudi stance on banknote printing	10
■ The USA and the EU	11
The international envoy and his team	11
Repercussions of escalation	12
■ To summarize, the safety concerns for the banking sector stem from several factors:	12
Crisis Resolution	17

Preface

The recent intensification of the conflict between the Central Bank of Yemen in Aden, affiliated to IRG of Yemen, and the Yemen Central Bank in Sana'a, under the control of the Houthi group (Ansar Allah), is intricately linked to a series of events that have unfolded in the banking sector over the past years. These events have largely revolved around each party's efforts to assert dominance over economic decision-making, extending beyond purely economic matters to encompass political and security concerns.

The root causes of the conflict trace back to 2016, when former Yemeni President Abd Rabbuh Mansour Hadi made a resolution to relocate the Central Bank of Yemen to Aden in response to the Houthi's control of the Yemeni capital, Sana'a. This move was prompted by accusations leveled against the Houthis of depleting the foreign currency reserves and encroaching upon the Yemen Central Bank's autonomy¹. Over the subsequent years, the relationship between the two banks, in Aden and Sana'a has been marked by fluctuations, notably highlighted by the Central Bank in Aden's decision to print varying banknotes of local currency. In response, the Central Bank in Sana'a prohibited the newly printed banknotes, in 2019, from being circulated in its held areas, and imposed several restrictions on currency exchange transactions with institutions affiliated with the Central Bank in Aden.

The in-question measures by the CBY in Sana'a were a watershed in the Yemeni banking landscape. As the disparity between the two currencies widened, citizens bore the brunt of these actions through escalating transfer commission fees, which soared to unprecedented levels². Subsequently, a series of unilateral measures ensued, with the Houthi authorities in Sana'a endorsing the contentious "Prohibition of Usury Transactions Law" as part of this escalating cycle.

1 - Statement by the Governor of the Central Bank of Yemen in Aden, Munser Al-Quaiti, dated September 20, 2016, in response to President Hadi's resolution to relocate the Central Bank to Aden. The statement was officially documented and can be accessed via the following link: https://www.bbc.com/arabic/middleeast/2016/09/160920_yemen_central_bank_aden

2 - Economic Indicators Report for the year 2020, titled "The Forced Separation of Yemen," released by the Studies and Economic Media Center (SEMCC) on February 27, 2021. The report is available for reference via the following link: <http://www.yemenief.org/Version-Details.aspx?js=64>

Recently, at the end of March 2024, the CBY in Sana'a announced, in a press conference, minting a new coin of one hundred Yemeni Riyals to replace the damaged banknotes of one hundred Riyals in its controlled areas, as the CBY in Sana'a claimed. Then, it was circulated in Sana'a on March 31, 2024.

However, this move was met with staunch opposition from the CBY in Aden, which deemed it not only hazardous and unlawful but also disregarding the financial interests of citizens. The CBY in Aden cautioned against engaging in transactions involving currency it deemed counterfeit, emphasizing the importance of adhering to banking regulations and norms ³.

Subsequently, the CBY in Aden, on April 2, 2024, gave all banks and financial institutions operating in the country a 60-day deadline to move their headquarters from the Houthi-controlled capital Sana'a to Yemen's interim capital of Aden.

These unfolding events thrust local banks and the financial sector in Sana'a into a heightened state of conflict, surpassing their current capacities and capabilities to effectively navigate. Simultaneously, they are compelled to contemplate a move to Aden in the near future or face severe punitive measures. The CBY in Sana'a has issued stern warnings, suggesting potential repercussions for institutions failing to comply with its orders, hinting at a possible suspension of their operations. These developments were underscored by statements from the Bank's governor, Hisham Ismail, during his recent meeting with Sana'a-based banks ⁴.

Overall, the issue of monetary policy has transformed into a quintessential political matter, with the banking sector evolving into a battleground utilized by various conflicting parties. Any efforts towards a solution must carefully consider the behind drivers of all parties involved and their approach to addressing this critical and influential aspect of Yemenis' lives.

3 - A statement issued by the Governor of the Central Bank of Yemen in Aden, dated March 30, 2024, link to the statement: <https://cby-ye.com/news/657>

4 - From the speech of the Governor of the Central Bank in Sana'a, Hashem Ismail, during his meeting with representatives of Yemeni banks in Sana'a, on April 6, 2024.

The Current Status Quo and the Stances of the Parties

The unilateral actions taken by the CBY in Sana'a to mint a new coin, countered directly by the CBY in Aden, signal the parties' plunge into a perilous confrontation. Retreat from this course of action may prove challenging, especially if the warring parties in Yemen perceive it as an opportunity to secure gains not achieved through warfare or ongoing negotiations mediated by third parties.

Amidst a complex situation, the banking sector, banks, and financial institutions are at the epicenter of a battle fraught with uncertainty, with potentially dire humanitarian and economic consequences looming large.

Before delving further, it's crucial to examine the economic and housing ramifications of these developments and their broader impacts. Subsequently, we'll scrutinize the stances adopted by various parties in response to these unfolding events.



The CBY in Aden

The CBY in Aden has taken decisive actions under the pretext of safeguarding Yemeni banks and the funds of depositors. Recognizing that the issuance of a new banknote in Sana'a is merely a precursor to potentially flooding the banking sector in areas under the group's control with additional new banknotes, the Management of the CBY in Aden perceives this move as a "test the waters". There's a palpable concern that, if not already underway, the Houthis might be preparing to print significant quantities of other banknotes, poised to introduce them at an opportune moment.

According to official statements from the Management of CBY in Aden, "new measures will be inevitable. And after the expiration of the two months respite, the CBY in Aden will begin gradually to impose penalties on non-compliant banks, to stop SWIFT, leading eventually to severance from the global banking system⁶.

Banks under the control of the Houthi group are expected to defy the decision initially, but they have no options but to implement it. The relocation of their headquarters to Aden is aimed at shielding them from interference by a group designated as a terrorist organization by the USA, as well as mitigating external risks stemming from such interventions. Failure to comply could jeopardize their relationships with foreign banks or result in the freezing of assets according to the management of the CBY in Aden.

The positions adopted by the CBY in Aden are underpinned by several key factors:

- ✓ The CBY in Aden holds international legitimacy and recognition.
- ✓ The CBY in Aden possesses the essential SWIFT Code and maintains control over banks' connections with foreign counterparts.
- ✓ Significant strides have been made by the CBY in Aden in institutional and supervisory reforms, through collaboration with the International Monetary Fund (IMF) and other global institutions. These efforts have bolstered administrative and operational efficiency, fostering increased trust between the CBY in Aden and international financial bodies.
- ✓ Political factions aligned with the IRG of Yemen have pledged their backing for the CBY's decisions aimed at countering the actions of the Houthi group in Sana'a, particularly regarding the minting of new coins.
- ✓ The USA and the EU have publicly voiced their support for the decisions made by the CBY in Aden. They have condemned the actions of the CBY in Sana'a, controlled by the Houthi group, regarding the issuance of new coins.

The Central Bank in Sana'a

The actions undertaken by the Houthis and the CBY in Sana'a are evidently geared towards asserting control and achieving complete economic independence. This pursuit stems from the Houthis' sense of isolation due to the lack of international recognition bestowed upon the CBY in Sana'a. Despite the Houthis' numerous efforts to garner international recognition, they failed to do so. They even faced many challenges such as cash liquidity crisis, local currency devaluation, and the large portion of damaged banknotes in their areas of control.

The CBY in Sana'a is introducing new currency denominations including the "one-hundred-riyal coin" and implementing heightened measures within the economic realm.

These initiatives are driven by several pivotal considerations:

- ✓ The Houthi is striving to bolster its internal resilience in the economic realm, leveraging the political and military momentum gained from recent events in the Red Sea. This includes direct confrontations with the USA and Britain, leading the group to perceive a degree of invulnerability against significant damage or influence from these nations across various spheres.
- ✓ The CBY in Sana'a is fostering informal ties with the KSA, employing a blend of diplomatic overtures and occasional veiled threats to secure economic gains outlined in a roadmap agreed upon by both parties. Finalizing procedures is the only remaining hurdle.
- ✓ Amidst the ongoing tensions between the USA and its European allies on one side, and Russia and China on the other, the CBY in Sana'a sees an opportunity to gain legitimacy on

the economic front. It views the evolving relationship between Russia and Iran as particularly advantageous, given its close ties with the Iranian regime.

- ☑ Internally, the CBY in Sana'a grapples with severe liquidity shortages in the local currency, compounded by the currency's deterioration and obsolescence, rendering it virtually unusable. It capitalizes on this crisis to justify its unilateral actions.

These circumstances drive the acute liquidity shortages to assert its relevance and prominence. It recognizes that the European and globally influential powers are increasingly turning to it in search of solutions.

The Saudi stance on banknote printing

The KSA has refrained from publicly announcing its position regarding the Houthi decision to print the "one-hundred-riyal banknote." This silence can be interpreted within the context of ongoing negotiation efforts between the KSA and the Houthis. Prior to recent events such as the Red Sea incident and the conflict in Gaza, both parties have engaged in discussions. This reluctance to take a definitive stance suggests the Saudi desire to preserve the progress made in its relationship with the Houthi. This relationship had advanced significantly, characterized by reciprocal visits and high-level delegations between Sana'a and Riyadh, and the agreement on numerous points outlined within the framework of the Yemen peace process.

The USA and the EU

The USA swiftly denounced the CBY in Sana'a's decision to issue new banknotes, categorizing them as counterfeit currency. Similarly, the EU expressed concern over this escalation, cautioning against unilateral actions that could exacerbate divisions within the Yemeni economy and undermine the integrity of the banking sector. Both entities emphasized the importance of adhering to international standards in combating money laundering and terrorist financing.

In tandem with this firm stance, the American envoy, Leander King, embarked on a new tour to the region at the end of the first week of April 2024. However, it's imperative to acknowledge that the announced American and European stances are not immutable or permanent. These parties remain open to exploring alternative avenues, spanning military, economic, and political realms. This flexibility hinges primarily on the negotiations surrounding Houthi attacks on American and British vessels in the Red Sea and the Gulf of Aden.

The international envoy and his team

On the international front, the office of the Special International Envoy (SIE) to Yemen, Mr. Hans Grundberg, has refrained from issuing any recent comments on the crisis. At present, the envoy and his team are actively employing various channels to engage with all involved parties, striving to understand the details of the issue and seek viable solutions within the framework of the peace process they espouse.

Repercussions of escalation




The intensification of the conflict has placed the banking sector in a precarious situation. Banks are facing a difficult dilemma, as they are caught between the Houthi's menacing threat of liquidation and seizure should they endeavor to move their headquarters to Aden, and the numerous administrative and technical obstacles preventing them from promptly adhering to the mandated deadline for relocation. Conversely, any reversal or failure by the CYB to enforce its decisions would deal a severe blow to its legitimacy. Such a backtrack would imply tacit approval of minting new currency, thereby potentially emboldening the Houthi group to introduce further coins or banknotes. Complicating matters, the CBY wields significant leverage with its SWIFT code and international recognition.

The ramifications of this crisis extend far beyond the banking sector, permeating into the economic and humanitarian aspects. Price hikes and increased human suffering are inevitable consequences, pushing the country towards a more dire economic and humanitarian crisis.

To summarize, the safety concerns for the banking sector stem from several factors:

- ✓ **Deepening monetary division.** The proliferation of multiple currencies circulating within the country exacerbates economic disparities and undermines the nation's financial stability. This fragmentation hampers efforts to assess the country's economic health accurately. While printing new banknotes by the CYB in Sana'a may yield short-term gains, it has significant strategic implications for the state and national economy. Uncoordinated issuance of banknotes deepens political divisions

and economic fragmentation, hindering progress towards a unified Yemen⁵. The adverse effects of currency fragmentation extend beyond short-term setbacks to medium- and long-term repercussions, which detrimentally impact the strength of the currency and its purchasing power. The presence of multiple currencies within a single country fragments its economic potential over the medium and long term.

-  **Decline or collapse of the banking sector.** The implementation of double decisions and sanctions against banks and exchange companies could lead to the collapse of the already vulnerable banking sector, impacting hundreds of thousands of depositors and service beneficiaries, as well as the livelihoods of thousands of families reliant on employment within this sector. Moreover, the repercussions will extend beyond the immediate financial sphere, exerting indirect pressure on the country's overall economic and developmental landscape, which is already grappling with the challenges of an eight-year-long conflict.
-  **The economic isolation of Houthi-controlled territories.** The economy in areas under the control of the Houthi faces severe isolation, exacerbating the suffering of millions of citizens both within and outside these regions. Economic stagnation casts a long shadow as a result leading to further limitations in job opportunities and declining incomes for tens of thousands of Yemeni families.
-  **Depreciation of the currency exchange rate.** The introduction of new coins or banknotes into the market is poised to exacerbate the depreciation of the exchange rate against foreign currencies, consequently fueling an escalation in the price levels of goods and services. This impact is particularly acute given the economic slowdown and recession experienced within regions under the control of the Houthi group. This move is anticipated to embolden authorities to increase currency issuance to cover their immediate expenses. Despite assertions from the CBY in

5 - An article by Dr. Mutahar Al-Abbasi, published on the Al-Masdar Online website on March 30, 2024 through the following link: <https://almasdaronline.com/articles/292651>

Sana'a that the newly issued coin is to replace the damaged banknotes, crucial details remain undisclosed. The precise quantity slated for release onto the market remains unspecified. In addition, it is still unclear whether this course of action will extend to other coins or banknotes or not. Moreover, the current valuation of the local currency against the US Dollar and other foreign currencies is distorted, as it is artificially fixed rather than reflecting genuine market dynamics. In a scenario where supply and demand dictate, the currency's value would likely surpass its current artificially imposed rate.

- ☑ **Challenges in financial transfers between the two regions and rising commissions and hurdles.** The challenges in financial transfers and increased transaction fees between the two regions are becoming more pronounced. The banking sector is poised to confront heightened complexities, particularly concerning financial transfers, with a concurrent surge in transfer fees owing to substantial disparities in the currencies utilized across both regions.
- ☑ **Persisting with unilateral decisions by the CBY in Sana'a** threatens to undermine not only the banking sector but also the country's adherence to international standards for combating money laundering and terrorist financing. Consequently, the ramifications of such decisions extend beyond the Houthi group, adversely affecting the banking and economic landscape of the entire nation.
- ☑ **Imposing restrictions on local banks from engaging with foreign counterparts** by halting the issuance of "SWIFT Codes" or citing non-compliance would deal a severe blow to these institutions and the banking sector at large. Such actions would precipitate significant economic and financial reverberations, making it arduous to lift restrictions in the future.
- ☑ **Technically and administratively, relocating bank and financial institution headquarters to Aden** within a short deadline presents formidable challenges. This endeavor necessitates

logistical, technical, and administrative arrangements incurring substantial financial costs for the banks. Moreover, the task of relocating personnel from their headquarters to Aden for different reasons poses multifaceted challenges, further complicating the situation.

- ✓ **Eroding regional and international confidence in the banking sector.** The proliferation of currency-issuing entities in the country falls short of the standards used to gauge economic growth rates and foreign exchange reserves. This lack of coordination with international financial institutions paints a grim picture, eroding confidence among international entities in their dealings with Yemeni financial institutions.
- ✓ **The elusive quest for a peaceful resolution and a comprehensive peace agreement.** The ongoing escalation between the two banks in Aden and Sana'a directly undermines Yemeni aspirations for reconciliation among local parties and reaching any peaceful settlement. Numerous discussions have underscored the imperative of fostering trust between the parties through the consolidation of monetary policy and currency unification as a humanitarian imperative for the Yemeni populace. This proposition was embedded within the framework of a peace roadmap tentatively agreed upon between the KSA and the Houthis. However, these efforts were derailed by the intensification of conflicts in the Red Sea and the unfolding events in Gaza.
- ✓ **The ongoing conflict exacerbates currency fluctuations,** induces significant instabilities within the financial and banking systems, and heightens dependence on the parallel market. This perpetuates a menacing threat to the country's financial and economic stability.
- ✓ **The persistence of conflict fosters a climate conducive to unilateral legislative actions** in the financial and banking sectors by each involved party. A prime example of this is the enactment of the "Prohibition of Usury Transactions Law," which

dealt a severe blow to the Yemeni banking sector, rendering Yemeni banks inert.

- ☑ **Imposing isolation on the CBY in Sana'a.** The economic isolation confronting regions under the Houthi control is a source of concern for the group. While the successful isolation of the group by the CBY in Aden would inflict a painful blow, it would also precipitate adverse effects on economic activities within these regions and on the populace residing there, comprising more than two-thirds of the country's population.
- ☑ **The potential success of the Houthi group in retaining control over the primary banks within their territories** after separation would deal a significant blow to the CBY in Aden and disrupt the economic framework in areas governed by the IRG of Yemen. This is especially critical given the fragile conditions of the banking system without the involvement of major banks. In such a scenario, banking activities would be confined to a limited number of institutions with constrained financial and human resources, including the National Bank (NB), CAC Bank, and recently established entities like Al-Qutaybi Bank and Hadhramout Bank, among others.
- ☑ **The ongoing conflict breeds instability** and uncertainty among companies, banks, and other components of the national economy, exacerbating stagnation, capital flight, and a scarcity of opportunities to address the crisis.
- ☑ **The issuance of banknotes without serial numbers by the CBY in Sana'a** poses a significant risk of counterfeiting and undermines confidence in the currency's authenticity.

Crisis Resolution

Amidst the escalating tensions between the CBY in Aden and Sana'a, there exists a window of opportunity to forge common ground and devise a viable solution. A potential solution lies in the formulation of a mechanism aimed at depoliticizing the banking sector and monetary policy, thereby neutralizing them from the ongoing conflict. This entails establishing a comprehensive set of standards delineating clear and specific professional guidelines for engaging with the banking sector. Such measures should prioritize the interests of the Yemeni populace and take into account the living conditions and humanitarian needs of citizens across the nation.

To address the crisis effectively, the following proposal is put forth:

- ✓ Proposing a resolution mechanism to address the current crisis involves positively engaging with the decision of the CBY in Aden, while simultaneously safeguarding the operations of banks in areas controlled by the Houthi group. This approach, guided by a set of standards, aims to insulate the banking sector from conflict and prevent further decisions and procedures that could harm the sector and weaken the national currency.

This proposal stands as a crucial and effective solution to address the current crisis, aimed at mitigating the detrimental impacts of escalating tensions and unilateral actions on the national economy and citizens. Given the potential scenarios of escalation and the failure to achieve common ground, compounded by the steadfast positions of each party and the risk of local banks severing ties with either authority or ceasing operations within their frameworks, the consequences could be catastrophic. Such a scenario may precipitate the collapse of the banking sector, with all the adverse repercussions outlined earlier.

In summary, the failure to establish a resolution mechanism will precipitate severe consequences on commercial and economic activities, as well as on the savings and accounts of depositors. This failure will further bolster parallel market activities, distancing them from the official banking system, and undermine the banking sector's adherence to compliance rules and anti-money laundering measures, despite Yemen's recent strides in this regard compared to the preceding years following the onset of the Yemeni conflict.

Any party's prioritization of political gains over the economic and humanitarian well-being of society constitutes a perilous gamble with the lives of millions of citizens enduring dire humanitarian and economic circumstances. Statistics affirm that more than half of Yemen's population requires urgent humanitarian assistance ⁶.

The Yemeni private sector, represented by the "Economic Reform Team (ERT," is putting forward this pragmatic proposal with a profound understanding of the grave consequences that citizens will endure, primarily stemming from the escalation of the current crisis. It emphasizes that pursuing a path towards settlement will alleviate the humanitarian suffering and living conditions, constituting a pivotal step towards peacebuilding, and restoring stability in Yemen.

⁶ - United Nations: More than half of the Yemeni people need assistance, published in UN News, February 6, 2024, via the link: <https://www.news.un.org/ar/story/2024/02/1128262>



The Economic Reform Team (ERT) represents a pioneering voluntary initiative, assembling an elite cadre of Yemeni businessmen, businesswomen, and economic experts. The ERT is dedicated to empowering the private sector's unified and impactful participation in decision-making processes, as well as the formulation of visions, strategies, and policies aimed at advancing economic reforms and growth across Yemen.

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