
# ANNUAL FINANCIAL STABILITY REPORT

## JULY 2018 - JUNE 2019

# CONTENTS

# LIST OF FIGURES



# LIST OF TABLES

# LIST OF ABBREVIATIONS

| | |
|---|---|
| **AEs:** | Advanced Economies |
| **CAR:** | Capital Adequacy Ratio |
| **CBR:** | Central Bank Rate |
| **DSR:** | Debt Service Ratio |
| **D-SIBs:** | Domestic Systemically Important Banks |
| **EAC:** | East African Community |
| **ECL:** | Expected Credit Loss |
| **EDWH:** | Electronic Data Warehouse |
| **EMDEs:** | Emerging Market and Developing Economies |
| **EU:** | European Union |
| **FRW:** | Rwandan Franc |
| **FSC:** | Financial Stability Committee |
| **FSD:** | Financial Stability Directorate |
| **FSR:** | Financial Stability Report |
| **FY:** | Financial Year |
| **GDP:** | Gross Domestic Product |
| **GWP:** | Gross Written Premium |
| **H1:** | First Half |
| **H2:** | Second Half |
| **HQLA:** | High Quality Liquid Assets |
| **IFRS:** | International Financial Reporting Standards |
| **IMF:** | International Monetary Fund |
| **KRR:** | Key Repo Rate |
| **LA:** | Left Axis |
| **LCR:** | Liquidity Coverage Ratio |
| **MFIs:** | Microfinance Institutions |
| **MMI:** | Military Medical Insurance |
| **NBR:** | National Bank of Rwanda |
| **NISR:** | National Institute of Statistics of Rwanda |
| **NOP:** | Net Open Position |
| **NPLs:** | Non-Performing Loans |
| **NSFR:** | Net Stable Funding Ratio |
| **RA:** | Right Axis |
| **RIPPS:** | Rwanda Integrated Payment Processing System |
| **ROA:** | Return on Assets |
| **ROE:** | Return on Equity |
| **RSSB:** | Rwanda Social Security Board |
| **RWA:** | Risk Weighted Assets |
| **SACCOs:** | Saving and Credit Cooperatives |
| **SMEs:** | Small and Medium Enterprises |
| **SSA:** | Sub-Saharan Africa |
| **US:** | United States |
| **U-SACCOs:** | Umurenge Saving and Credit Cooperatives |
| **WEO:** | World Economic Outlook |
| **YoY:** | Year on Year |

> “The NBR defines financial stability as a condition when the financial system (institutions, markets and infrastructures) is able to provide financial products and services to economic agents in a sustainable manner at all times, including when faced with shocks.”

# GOVERNOR'S STATEMENT

Welcome to this edition of the National Bank of Rwanda (NBR) Financial Stability Report (FSR). Maintaining a sound financial system and achieving low and stable inflation are two main mandates of the NBR. The NBR financial stability mandate is founded on the fact that a sound financial system is a necessary precondition for economic goals like sustainable economic growth, employment creation, poverty reduction and the broader economic development.

The NBR defines financial stability as a condition when the financial system (institutions, markets and infrastructures) is able to provide financial products and services to economic agents in a sustainable manner at all times, including when faced with shocks.

The annual FSR is the NBR flagship report that summarizes performance of the financial sector, documents domestic and external risks facing the sector, and highlights the planned and implemented policy instruments to safeguard financial stability. The report is meant to guide policy makers, financial institutions, investors, development partners and the general public to make appropriate and informed decisions.

The macroeconomic environment remained conducive for financial sector growth and stability during the financial year 2018/19. Rwandan economy grew by 8.6 percent in 2018, the highest in the last 3 years and one of the highest globally. A strong growth of economic activities increased the capacity and opportunities of financial institutions to invest, increased their profits and, enabled financial institutions to maintain capital and liquidity buffers above the prudential requirements. Economic growth is projected to remain strong in 2019 and to continue supporting financial stability.

The projected weak global economic growth related to global trade tensions and relatedly falling commodity prices is the main external risk facing the Rwandan economy and the financial sector in particular. The deterioration of global conditions would reduce demand for Rwandan exports, exert pressure on exchange rate and constrain policy flexibility to support growth. Domestic risks to the Rwandan financial system relate to credit concentration, high banking sector exposure to commercial real estate and falling prices for office space buildings.

Going forward, the NBR will always ensure that financial institutions hold capital and liquidity positions commensurate with the risks they undertake. Over the last 12 months, the NBR implemented a number of legal instruments and initiatives aimed to addressing the identified risks.

**John RWANGOMBWA**
Governor

# **NBR** IDENTITY STATEMENT

The National Bank of Rwanda strives to become a world class Central Bank that contributes to the economic growth and development by using robust monetary policy tools to maintain stable market prices. The Bank embraces innovation, diversity and inclusiveness, economic integration and ensures financial stability in a free market economy.

# VISION

To become a World Class Central Bank

# MISSION

To ensure Price Stability and a Sound Financial System

# OUR CORE VALUES

## INTEGRITY

We uphold high moral, ethical and professional standards for our people, systems and data

## ACCOUNTABILITY

We are result-focused and transparent, and we reward according to performance

## MUTUAL-RESPECT AND TEAM-WORK

We keep ourselves in high spirit, committed to each other for success

## EXCELLENCE

We passionately strive to deliver quality services in a timely and cost effective manner. We continuously seek improvement by encouraging new ideas and welcoming feedback that adds value to customer services.

# GLOBAL ECONOMIC AND FINANCIAL DEVELOPMENT

A weak global economy is a risk to the Rwandan economy. As an open economy, Rwanda largely relies on exports to finance its external receipts at the tune of 41.1 percent as at December 2018. The National Bank of Rwanda therefore monitors developments and vulnerabilities related to the global economy and the channels through which they can affect the Rwandan economy and the financial sector in particular. Sections below summarize the recent developments and outlook of the global economy and their potential impact on the Rwandan economy.

**Global economic growth has weakened amid heightened trade tensions, volatile financial conditions and falling commodity prices (Table 1).** The global economic growth slowdown to 3.6 percent in 2018 from 3.8 percent (Year-on-Year) in 2017 (IMF WEO, October 2019). This slowdown particularly happened in the second half of 2018, reflecting a combination of factors like increase of trade tensions and tariff hikes between the United States and China, a decline in business confidence, a tightening of financial conditions, and higher policy uncertainty across many developed and emerging economies. The economic activities in Advanced Economies (AEs) decelerated to 2.3 percent in 2018 from 2.4 percent in 2017. In particular, the growth in the US improved, bolstered by fiscal stimulus. The Euro area growth momentum moderated in 2018 due to weaker consumer and business confidence in this region, the disruption of car production in German by the introduction of the new emission standards, low investment and widening of sovereign spreads in Italy. Weaker than expected growth in China was driven by deleveraging and de-risking policies, as well as, trade tensions with the US.

**The global economy is projected to remain subdued in the near-term (Table 1).** As at October 2019, the IMF projects the global economy to grow at 3 percent in 2019, and to pick up to 3.4 percent in 2020. The increase of trade tariffs between the United States and China imply weaker trade volumes and increased uncertainties for investors. Brexit related uncertainties also could continue weighing down long-term investments. Data for the first half of 2019 indicates that economic activities remain muted in several advanced and emerging countries- The IMF WEO indicates that global investment and demand for consumer durables have been subdued across advanced and emerging market economies in H1 2019 as firms and households continue to hold back on long-term spending.

Table 1: Global Growth Projections

| GROWTH PROJECTIONS BY REGION | 2017 | 2018 | 2019 PROJ. | 2020 PROJ. |
|---|---|---|---|---|
| World | 3.8 | 3.6 | 3.0 | 3.4 |
| Advanced Economies | 2.4 | 2.3 | 1.7 | 1.7 |
| United States | 2.2 | 2.9 | 2.4 | 2.1 |
| Euro Area | 2.4 | 1.9 | 1.2 | 1.4 |
| Japan | 1.9 | 0.8 | 0.9 | 0.5 |
| United Kingdom | 1.8 | 1.4 | 1.2 | 1.4 |
| EMDEs | 4.8 | 4.5 | 3.9 | 4.6 |
| Russia | 1.6 | 2.3 | 1.2 | 1.9 |
| Brazil | 1.1 | 1.1 | 0.9 | 2.0 |
| China | 6.8 | 6.6 | 6.1 | 5.8 |
| India | 7.2 | 6.8 | 6.1 | 7.0 |
| Sub-Saharan Africa | 2.9 | 3.2 | 3.2 | 3.6 |

Source: **IMF WEO, October 2019**

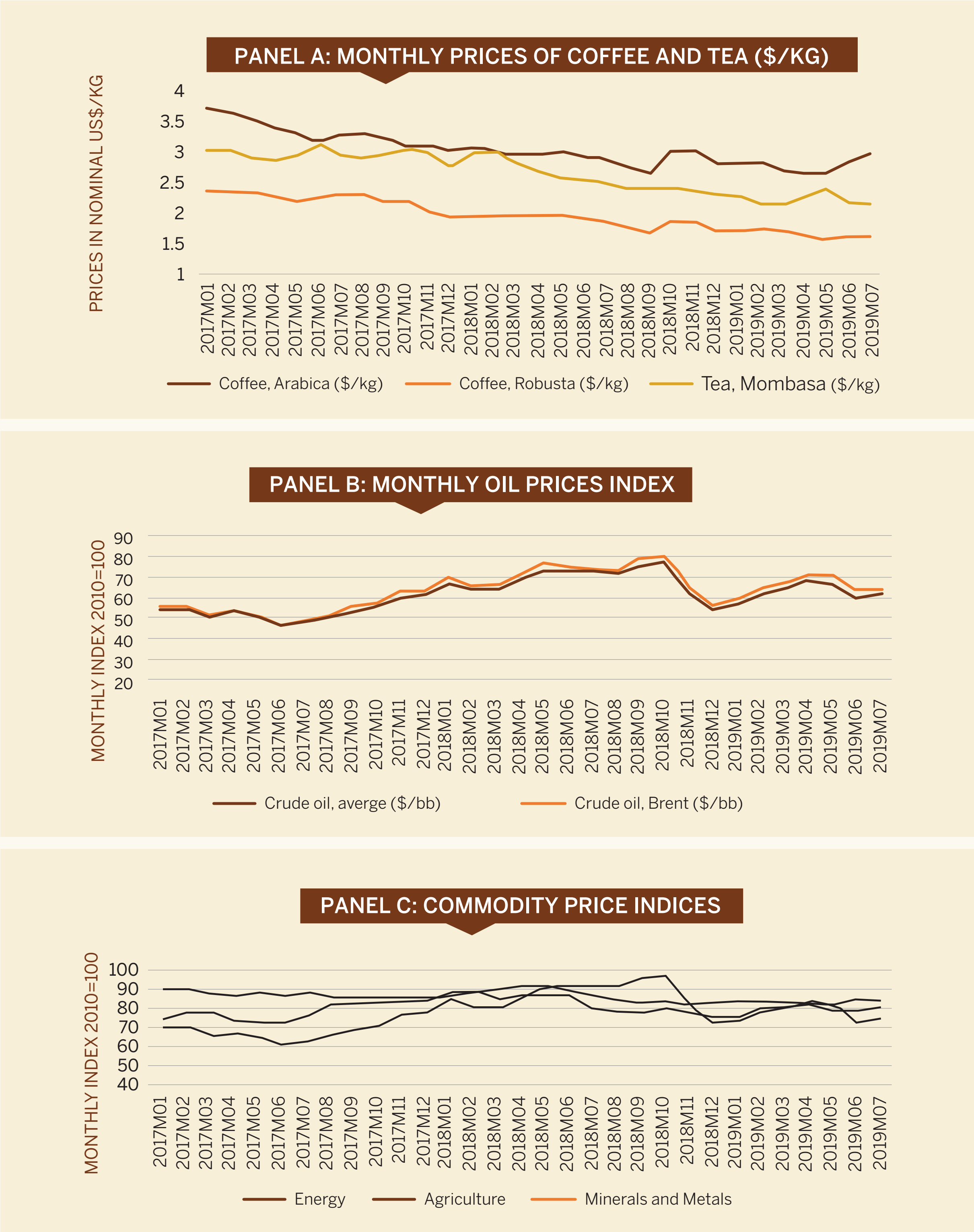
**Global financial conditions tightened during the first half of 2019, reflecting deteriorating market sentiments due to trade tensions, slowing global growth, moderately less buoyant corporate earnings and prospects for a disorderly exit of the United Kingdom from the European Union (a "no-deal Brexit").** Much as most of these concerns remain, several countries implemented an accommodative monetary policy in 2019, largely to support aggregate demand and phase out prevailing disinflation conditions. In light of accommodative monetary policy, market expectations for the future path of policy rates have adjusted downward causing a reduction of longer-term interest rates in 2019. In the medium-term, however, the very low interest rate and high government and corporate debt levels in some advanced economies could constrain policy response to global slowdown and tighten financial conditions.

**Economic recovery continued in Sub-Saharan Africa (Table 1).** Despite the unfavorable global conditions, economic growth in SSA strengthened from 2.9 percent in 2017 to 3.2 percent in 2018. This recovery was largely supported by rising agricultural production related to favorable weather conditions, increased infrastructure investment among non-resource intensive countries, and a modest rebound in exports in the second half of 2018 that benefited oil-exporting countries. Near-term risks to SSA growth relate to declining global growth momentum, unreliable and volatile weather conditions, debt vulnerabilities that remain elevated in some SSA countries, high nonperforming loans and increasing public domestic arrears that continue to put a strain on the financial sector.

**Developments in commodity prices stayed broadly unfavorable for oil-importing countries like Rwanda since the beginning of 2019.** Oil prices have been increasing since January 2019 supported by production cuts of countries under the Organization of Petroleum Exporting Countries (OPEC) - (Figure 1, Panel B). The price of oil is expected pick-up further in the near-term, following the recent decision by OPEC to extend oil-supply cuts until March 2020. On the other hand, prices of metals and agricultural commodities remained stagnant in the first half of 2019, after falling in the second half of 2018, following the imposition of new U.S. tariffs on imports from China. Prices of agriculture commodities and metals are expected to pick-up in the later months of 2019 on expectations that ongoing negotiations between China and the United States may avert more dramatic increases in tariffs.

**Prices of tea and coffee, Rwanda's traditional agriculture exports have steadily dropped since 2017 (Figure 1, Panel A).** Average prices of tea at the Mombasa auction dropped from $ 2.42 per kg in H2 2018 to $ 2.24 per kg in H1 2019. (i.e., 7.3 percent decline). Similarly, the price of Arabica coffee, Rwanda's main coffee export, dropped from $ 2.87 per kg in H2 2018 to $ 2.77 per kg in H1 2019. The declining tea prices reflect large tea production and increasing inventory due to favorable weather conditions in East Africa and India. The falling prices of coffee was caused by increased production, especially in Brazil and Vietnam, the World's main coffee producers, and weaker-than-expected consumption. Coffee and tea prices are projected to remain low, largely due to higher production compared to consumption. In-terms of policy implication, slumping coffee and tea prices imply the need for diversification of exports for countries that highly depend on them.

Figure 1: Recent Developments in Commodity Prices



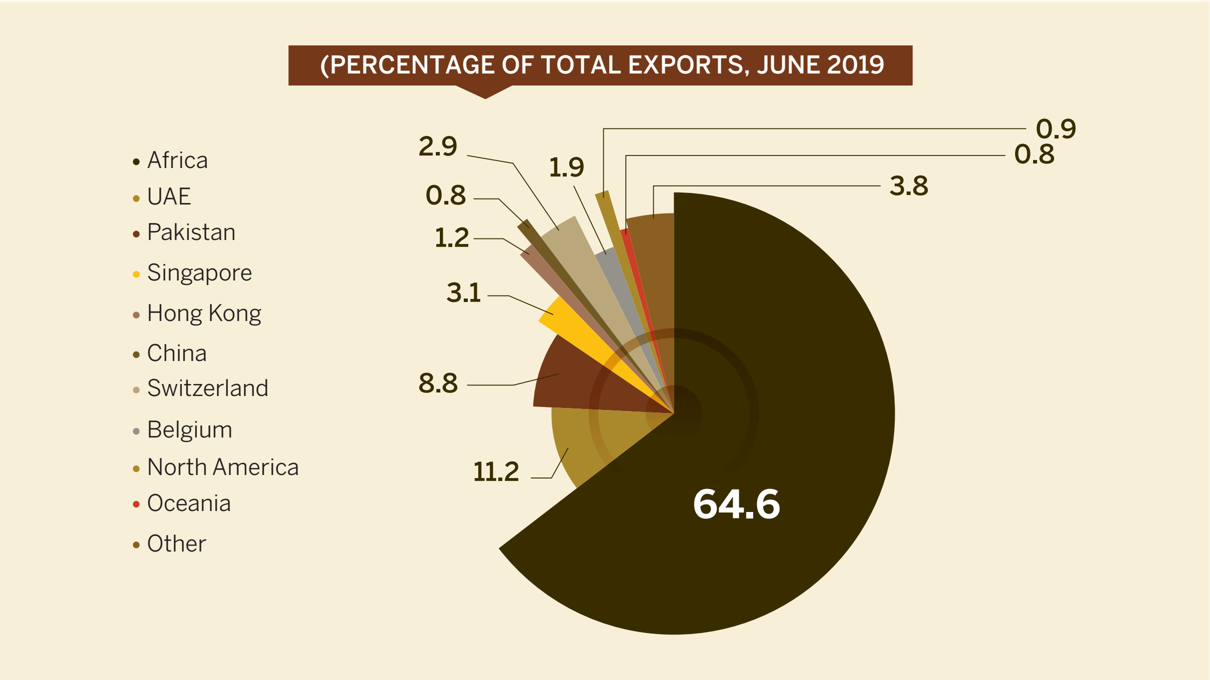

Source: **World Bank, August 2019**

**Rwanda is exposed to global economic developments mainly through trade links.** Rwanda finances its import bill largely from export earnings-export receipts covered 41.1 percent of total import bill at end December 2018. The slowdown of the global economy is therefore a risk to the Rwandan economy as it affects demand for its exports of goods and services. The recent slump of agriculture and metal prices on international market is therefore a challenge and risk to the Rwandan economy.

**The impact of tighter global financial conditions on Rwanda's financial sector is still limited and indirect.** Rwanda's financial sector is still less connected to the rest of global financial markets. As at end June 2019, Rwandan banks' off-shore financing stood at 8.1 percent of banks' liabilities. A large portion of banks funds are from customer deposits- at 77.1 percent of total banking system liabilities as at end June 2019. Deposits are mainly from residents (96.7 percent of total deposits) of which 74 percent of total deposits are denominated in local currency. Funds from interbank account for 16.5 percent of total liabilities. This funding profile indicates that volatility in global financial market would pose less direct shocks on Rwandan financial firms. Nevertheless, the impact of heightened tighter global conditions would hurt growth of trading partners and ultimately constrain demand for Rwandan exports of goods and services as well as inflows of official development assistance and capital raising initiatives.

**The projected positive economic outlook for Sub-Saharan Africa is an advantage for the Rwandan economy.** Rwanda exports 64.6 percent of its total exports to fellow Sub-Saharan Countries- this mainly includes food exports and re-exports. This implies that performance of African economies is of particular importance to Rwanda's economic performance through trade (Figure 2). The IMF, in its October WEO, projects that SSA will remain resilient to global shocks and its growth would improve from 3.2 percent in 2019 to 3.6 percent in 2020. The other region whose growth is important for Rwandan economy is Asia- the main destination of Rwanda's mineral exports (Wolfram, Cassiterite and, Colombo-tantalite (Coltan). The normalization of trade arrangements between USA and China is positive for Rwanda mineral export performance.

Figure 2: Rwanda's Trading Partners




Source: **NBR, Statistics Department**

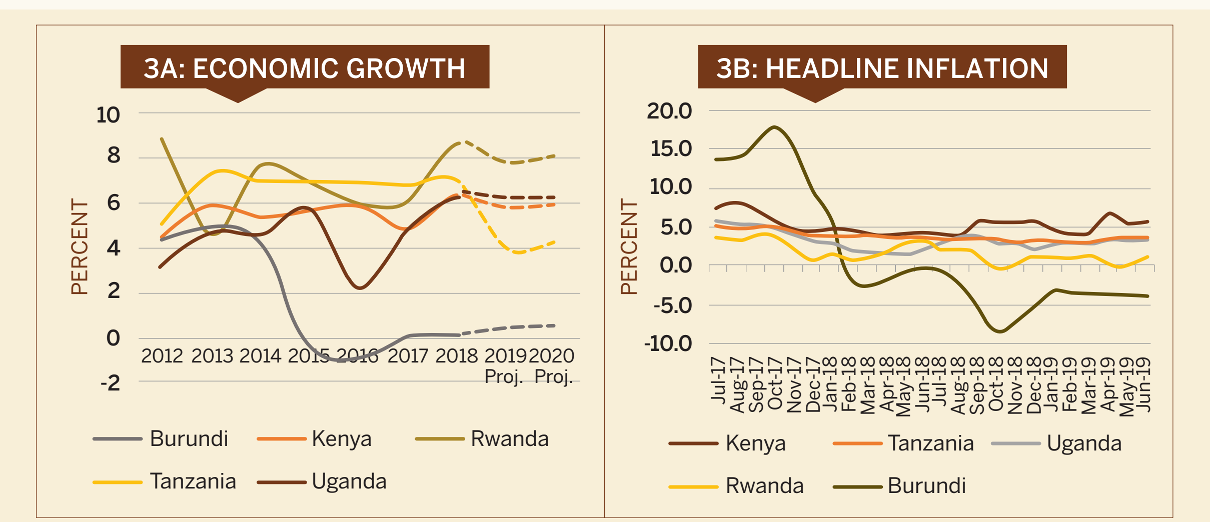
## ECONOMIC AND FINANCIAL SECTOR PERFORMANCE OF THE EAST AFRICAN COMMUNITY (EAC)

**The performance of the East African Community (EAC) economies is important for the Rwandan economy and financial system.** The interlinkages between Rwanda and the rest of the EAC economies is through trade and connected financial systems. For example, during the first half of 2019, 22.3 percent of Rwanda's exports were to partner states in the EAC, while 16.7 percent of its imports were from partner states in the EAC. Rwanda is also connected to the EAC through financial sector linkages, most especially Kenya- Rwanda hosts subsidiaries of 5 Kenyan banks (Equity, KCB, CBA, GT Bank and I&M) with a combined asset share of around 29 percent of total banking sector assets. Rwanda also hosts subsidiaries of 3 Kenyan insurance companies (UAP, Britam and Mayfair) with a share of around 14 percent of the total assets of private insurance companies. Most of these financial institutions have footprints in other EAC member states, potentially making contagion risks. Rwanda reduced this cross-border risk through licensing regional banks as subsidiaries, as opposed to branches. Nevertheless, economic performance and stability of regional financial systems is important for Rwanda's financial system. In sections below, we provide a summary of the recent performance of the EAC economies and financial systems.

**Economic growth strengthened in the EAC region.** The average real GDP growth for the EAC improved from 5.6 percent in 2017 to 6.3 percent in 2018, the highest among the SSA regional block. Stronger growth in the region was supported by stronger growth of services, agriculture and increased infrastructure investment. At country level, economic growth was strongest in Rwanda (8.6 percent from 6.1 percent), followed by Tanzania (7.0 percent from 6.8 percent), Kenya (6.3 percent from 4.9 percent) and Uganda (6.2 percent from 4.8 percent). Economic growth remained subdued in Burundi for the third year in a row.

**Monetary policy remained accommodative across the region and inflation remained subdued.** Inflation slowed in the EAC region because of favorable weather conditions that supported increased food production and low food prices (Figure 3B). Low inflation allowed EAC Central Banks to pursue an accommodative monetary policy to support lending to the economy. The Central Bank of Kenya (CBK) reduced the Central Bank Rate (CBR) by 50 basis points to 9 percent in September 2018. The Bank of Tanzania (BOT) eased the CBR by 200 basis points in September 2018, while NBR cut the CBR by 50 basis points to 5 percent in May 2019. Consistent with eased monetary policy, banks' lending improved across the EAC region (Figure 4). The uptick of lending largely reflected improved demand for credit in line with improved economic activities, a relatively lower cost of borrowing and improvement in asset quality as evidenced by lower non-performing loans (NPLs) in some member states.

Figure 3: Economic Growth and Inflation Development in EAC

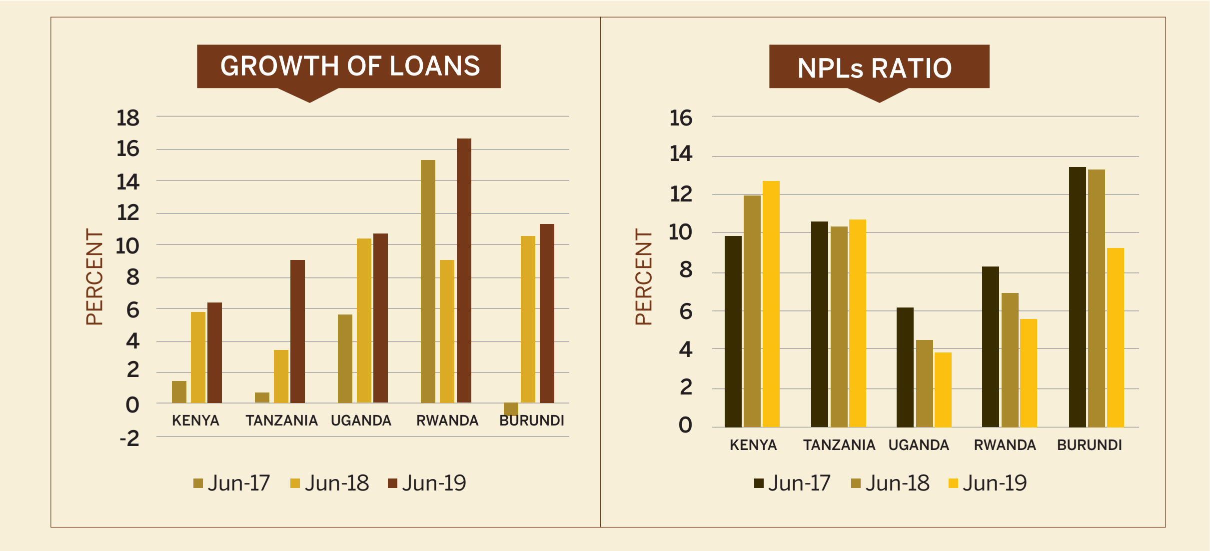



Source: **Country Bureau of Statistics and IMF WEO, July 2019.**

**Credit risk remains the key financial sector risk facing EAC countries despite the recent slight reduction of the NPLs ratio in some countries.** Loans account for the largest portion of EAC banking sector asset portfolio- the size of loans in total banking sector assets stood at 59 percent in Rwanda, 53.7 percent in Tanzania, 53.2 percent in Kenya, 43.8 percent in Uganda and 33.8 percent in Burundi. With this asset structure, the quality of loans determines profits, capital and liquidity of banks in the region. Over the last 12 months, the NPLs ratio dropped in Rwanda, Uganda and Burundi due to varying reasons that include write-offs and improved economic activities that improved corporate profits and accelerated new lending. However, the NPLs ratio increased in Kenya and Tanzania (Figure 4) largely due to delayed payments by both public and private entities and reduction in real estate occupancy and prices.

Credit risk in the region is further exemplified by a concentrated banking loan book, where building and construction account for 35 percent of banking sector loans in Kenya, 37 percent in Rwanda, 28 percent in Uganda , 23 percent in South Sudan and 11 percent in Tanzania. Such loan book implies that volatility in housing market would weigh-on the EAC banking sector performance. Key intervention to contain credit risk in the EAC region include, diversification of the loan portfolio, improving the credit information system, financial education programs to sensitize the public on responsible borrowing, enhancement of collateral realization process, and commitment of Government to reduce public arrears.

Figure 4: Lending and Asset Quality Development in EAC




Source: **Partner States Central Banks**

**The Banking sector in the EAC remains adequately capitalized; liquid and profitable (Table 2).** The capital adequacy ratio - a measure of how effectively banks can sustain a reasonable amount of loss - remained above the prudential limits of 15 percent across the region. Capital buffers represent an extra measure of safety in the event of unexpected loss.

On the other hand, the liquidity ratio, which gauges the ability of banks to meet customers' demands, remained above the minimum prudential requirement of 20 percent in all EAC partner states. The Banking sector remains profitable in across the EAC partner states although profits dropped in some countries in 2018, compared to 2017.

Table 2: Financial Soundness Indicators of EAC Banking Sectors

| CAR (%) | DEC-17 | MAR-18 | JUN-18 | SEP-18 | DEC-18 | MAR-19 | JUN-19 |
|---|---|---|---|---|---|---|---|
| KENYA | 18.47 | 18.70 | 18.00 | 17.5 | 18.7 | 18.4 | 18.2 |
| TANZANIA | 19.74 | 20.00 | 20.20 | 18 | 18 | 18.4 | 18.1 |
| UGANDA | 23.18 | 23.83 | 21.80 | 21.6 | 21.6 | 22.2 | 22.1 |
| RWANDA | 21.40 | 21.10 | 21.92 | 22.6 | 25.5 | 24.1 | 23.3 |
| BURUNDI | | | 24.40 | 25.8 | 24.1 | 25.4 | 27.4 |
| **LIQUIDITY RATIO (%)** | **DEC-17** | **MAR-18** | **JUN-18** | **SEP-18** | **DEC-18** | **MAR-19** | **JUN-19** |
| KENYA | 47.43 | 49.70 | 50.50 | 52.6 | 46.5 | 49.8 | 50.6 |
| TANZANIA | 48.61 | 47.60 | 45.50 | 41.9 | 42.6 | 42.1 | 45.6 |
| UGANDA | 54.57 | 52.85 | 46.57 | 43.9 | 45.5 | 44.1 | 45.5 |
| RWANDA[1] | 43.73 | - | - | - | - | - | - |
| **ROA (%)** | **DEC-17** | **MAR-18** | **JUN-18** | **SEP-18** | **DEC-18** | **MAR-19** | **JUN-19** |
| KENYA | 2.7 | 2.9 | 2.7 | 2.6 | 2.6 | 2.9 | 2.7 |
| TANZANIA | 1.4 | 1.7 | 1.6 | 1.6 | 1.6 | 1.1 | 1.8 |
| UGANDA | 2.7 | 2.6 | 2.8 | 2.8 | 2.5 | 2.8 | 2.7 |
| RWANDA | 1.1 | 2.5 | 2.7 | 2.8 | 3 | 3.1 | 2.6 |
| BURUNDI | 4.6 | 0.7 | 1.3 | 2.3 | 2.8 | 0.9 | 1.9 |
| **ROE (%)** | **DEC-17** | **MAR-18** | **JUN-18** | **SEP-18** | **DEC-18** | **MAR-19** | **JUN-19** |
| KENYA | 20.8 | 22.9 | 23.7 | 22.8 | 22.5 | 24.6 | 23.8 |
| TANZANIA | 5.9 | 8.5 | 7.1 | 6.6 | 3.8 | 7.7 | 8.8 |
| UGANDA | 16.4 | 15.0 | 16.7 | 16.3 | 14.4 | 15.9 | 15.8 |
| RWANDA | 6.2 | 7.6 | 9.5 | 10.2 | 11.2 | 12.0 | 9.3 |
| BURUNDI | 6.3 | 5.4 | 10.4 | 9.3 | 22.9 | 8.2 | 17.3 |

Source: **EAC Central Banks**

[1] Rwanda implemented the Liquidity Coverage Ratio since 2018.

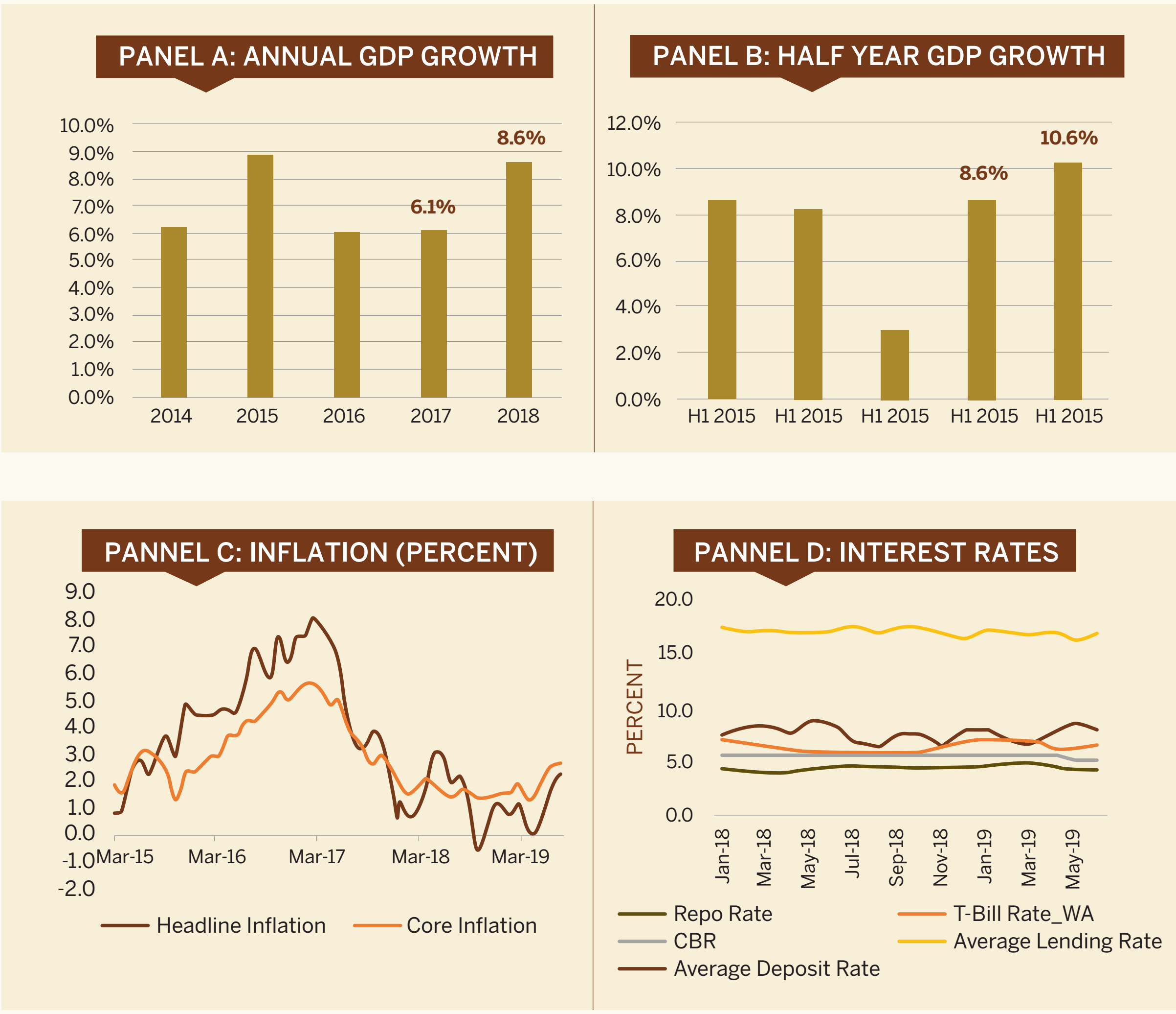
# DOMESTIC MACROECONOMIC DEVELOPMENT

**Rwanda's economic growth accelerated to 8.6 percent in 2018, the highest in the last three years (Figure 5A).** Strong growth continued in the first half of 2019, at 10.3 percent - the highest half-year growth in the last 5 years. This robust growth reflects a good performance of the industry sector (construction and the manufacturing), as well as, services. A breakdown of GDP growth by production approach indicates that the agriculture sector grew by 5.9 percent in 2018, against 6.6 percent in 2017, industry sector (10.3 in 2018 against 4.5 percent in 2017) and services sector (8.8 percent in 2018 against 7.9 percent in 2017). Economic growth is projected to remain robust in the near-term (7.8 percent in 2019 and 8.5 percent in 2020) supported by public and private investment. In the outlook, the projected vibrant economy will continue supporting growth and stability of the Rwandan financial sector through increased domestic resource mobilization, increased demand for loans and insurance policies, reduction of NPLs and increased profits.

**Inflation remained moderate largely due to a good agricultural harvest (Figure 5C).** Headline inflation averaged at 0.8 percent (Y-o-Y) in FY 2018/2019, down from 2.3 percent in FY 2017/16. During the same period, core inflation that represents the long run trend in the price level, by excluding volatile items like fresh food and fuel, remained also moderate, at an average of 1.5 percent, lower than 2.3 percent recorded in the previous year. The slowdown of inflation largely mirrors food and energy lower prices following favorable weather conditions and the decline in charcoal and firewood prices. The NBR projects inflation to pick-up in the second half of 2019, but thereafter remain within the benchmark of 5 percent with a symmetric band of 3 percent. The stable inflation registered in Rwanda in the recent past is a positive condition for financial market players as it offers savers and investors the reliable estimate of their future returns on investment. Particularly for banks and MFIs, inflation is among the key variables used to determine lending rates.

**Interest rates slightly dropped reflecting an accommodative monetary policy implemented by the NBR.** After maintaining the Central Bank Rate (CBR) at 5.50 percent since December 2017, the NBR reduced the CBR to 5 percent in May 2019, purposely to support private sector financing amidst low inflation and stable exchange rate. Generally, market rates (lending rate and deposit rate) dropped during the financial year 2018/19 compared to 2017/18. The average lending rate of banks dropped from 17.13 in FY 2017/18 to 16.7 percent in FY 2018/19. Similarly, the average deposit rate of banks fell from 7.8 percent to 7.2 percent during the same period. The average interest rate spread of banks (difference between lending rate and deposit rate) dropped from 9.53 percent in FY 2018/27 to 9.3 percent in FY 2019/18. From a profitability perspective, the reduction of interest rate spread was compensated by high growth of recoveries from write-offs.

Figure 5: Real GDP Growth, Inflation and Interest rate Developments




**Overall, interest rate are stable in Rwanda and the repricing risk remains minimal for banks.** Unlike in markets where interest rates fluctuate so fast and financial institutions face a repricing risk -risk related to changes of interest rate charged on assets compared to liabilities, interest rates in Rwanda remain largely stable with only small short-term variations. Figure 5D above indicates interest rates for the last 2 years, and clearly, there has not been significant shocks on market interest rates, implying that banks can predict their future returns on investments they make.

# SYSTEMIC RISKS ASSESSMENT

**The Banking sector is still over reliant on short-term resources.** Banks are faced with a challenge of short-term funds that constrain them to finance long-term investments with minimal risk. Rwandan banks rely on deposits at a tune of 77.1 percent of their total liabilities. Most of these deposits are short-term- for example, as at end June 2019, close to 60.7 percent of banks' deposits were demand deposits - funds that can be withdrawn any time. Out of 39.3 percent term deposits held by banks, 91.1 percent also hold a maturity of less than 1-year. Although maturity transformation is part of the normal business of banks, excessive maturity transformation could be a risk to the Banking Sector. Additionally, for risk averse banks, short-term resources limit their ability to underwrite long-term feasible projects with higher returns.

More efforts are needed to improve the saving culture among Rwandan households and firms. Over the recent past, the Government has implemented a couple of initiatives to incentivize long-term savings. For example, in April 2018, the Government waived the withholding tax (15 percent) on deposits in financial institution with maturity of more than 1 year and as a way to encourage long-term saving. For long-term saving to pick-up, such efforts need to be complemented by a well-structured financial education programs by both the Government and financial sector players.

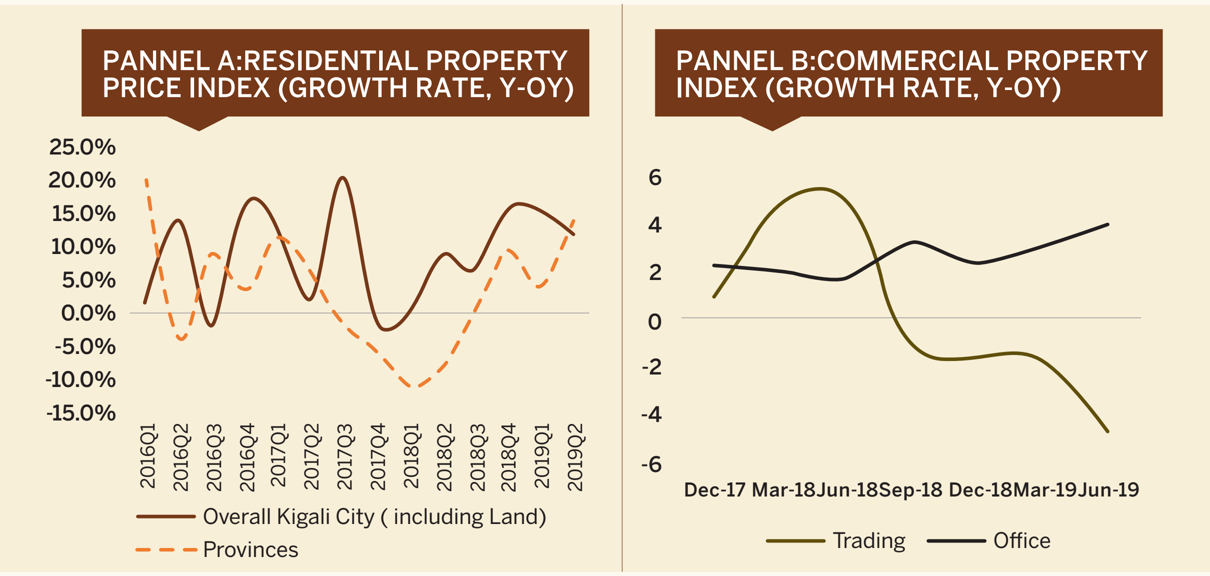
**Concentration of loans to few borrowers is another risk facing lending financial institutions.** As at end June 2019, the total outstanding loans of banks (FRW 2,008 billion) went to 378,809 beneficiaries (this accounts for 5.2 percent of total adult population). The NBR survey on large corporate clients of banks conducted in June 2019 also indicated that top 50 corporate loans account for 34.3 percent of total loan portfolio of banks. This indicates that banking loan portfolio is still concentrated and therefore the returns on the underlying assets could be correlated, implying that a shock on a few borrowers would pose significant distress on the Banking Sector. Cognizant of this risk, the NBR issued Regulation N°13/2017 of 23/11/2017 on management of credit concentration that sets the maximum banks total exposure to a single counterparty or to a group of connected counterparties to 25 percent of The Bank's core capital. As at end June 2019, all banks complied with this single obligor limit. Despite this prudential measure established by the NBR, there is need for the Banking industry to diversify their clientele by designing products, services and channels that suit their conditions. Competition of a few corporate clients in towns and semi-urban areas limits growth of financial institutions, but also opens them to potential risks.

**The financial sector exposure to the mortgage sector remains high, although new lending to this sector moderated in 2019.** Over the last five years, increasing exposure of banks to the mortgage sector, in-form of loans has been among the key financial stability risks identified and monitored by the NBR (Figure 7). The share of mortgage loans to total loans of banks increased from 29.4 percent in June 2014 to 34.9 percent in June 2019 (in-terms of value, this increased from FRW 270 billion to FRW 673 billion). With this concentrated loan book, where more than a third of banking sector loans is to mortgage, banks are exposed to shocks that could hit the mortgage sector- this could be on housing prices or household incomes. Banks have realized and weighed these risks and have started diversifying their new investments to other sectors. For example, over the first six months of 2019, new loans to the mortgage sector increased by 10 percent, effectively the lowest growth compared to the average growth of 20 percent in the first halves for the last 5 years.
High growth of new lending during the first half of 2019 happened in manufacturing (20.6 percent), transport and communication (54 percent), water and energy (91.2 percent). Further diversification of the Banking sector loan portfolio is important for safety and stability of the sector.

**Declining rental prices of commercial buildings and seemingly slowing residential property prices is another challenge to the financial sector.** To monitor financial sector risks related to the housing market, the NBR monitors real estate property (houses and land) prices in Kigali City and Provinces. In these assessments, the NBR uses residential property sales data from Rwanda Land Management and Use Authority (RLMUA). For commercial properties, with less frequent sales, the focus is on rental prices of commercial houses in Kigali city. Commercial properties are categorized between office spaces and trading spaces.

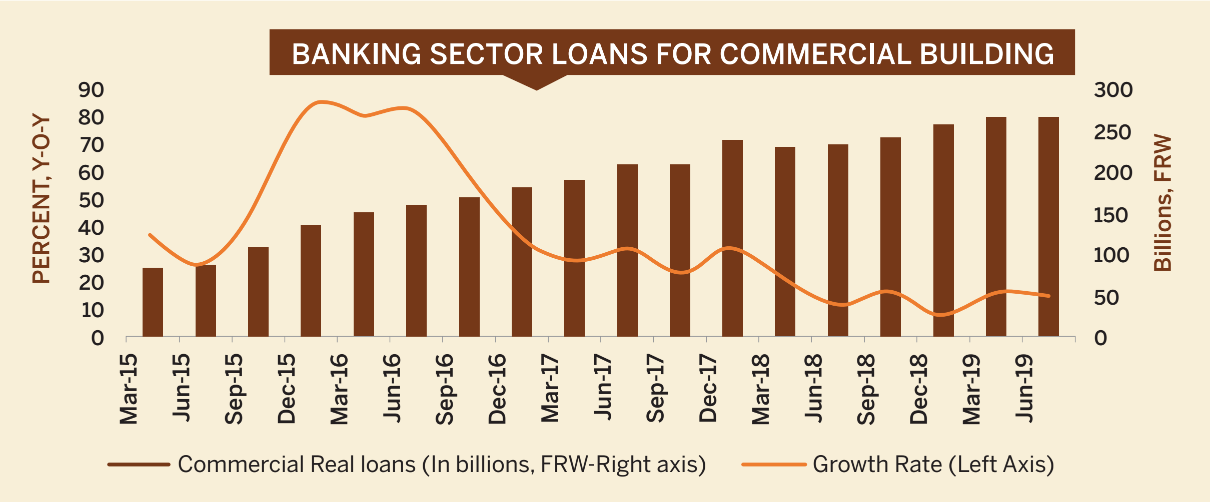
The latest assessment performed in June 2019 indicated that rental prices for trading spaces dropped since the third quarter of 2018 (Figure 6B). The overall index declined by 6.0 percent (Y-O-Y) for trading spaces, but increased by 4.1 percent for offices. This trend indicates the increasing supply for commercial building that have outmatched demand. If rental prices continue to drop in future, it could pose stress to banks that have financed these establishments. Banks realized prevailing risks related to commercial houses and have recently steadily reduced their pace of lending for commercial buildings projects (Figure 7).

Figure 6: Real Estate Price Index




Source: **NBR Staff calculations based on RLMUA data**

Figure 7: Banking Sector Loans to Commercial Houses




Source: **NBR, Financial Stability Directorate**

**The NBR Directive establishing the Loan-To-Value (LTV) limits aimed at containing banks exposure to commercial real estate.** Effective April 2019, the National Bank of Rwanda (NBR) established a Directive on Loan-To-Value (LTV) limits (Directive No 2600/2019-00015 (613). This Directive caps the size of mortgage loans relative to the value of the property associated with the loan. As per this Directive, the LTV limits for construction or purchase of commercial property was established at 80 percent - meaning that the Bank can contribute up to 80 percent of the value of the property and the borrower contributes 20 percent. The LTV limit for residential properties was established at 100 percent for the first house and 80 percent for subsequent houses. The NBR shall regularly review these limits basing on developments in the housing market and credit market.

**Domestic Systemically Important Banks (D-SIBs) are adequately capitalized and liquid (Box 1 summarizes the methodology used by the NBR to assess D-SIBs).** As part of its framework to monitor systemic risks facing the financial sector, the NBR implemented a framework in 2018 to identify, regulate and supervise Domestic Systemically Important Banks (D-SIBs). These are institutions whose failure might largely distort the functioning of the financial system with substantial impact on the economy. The methodology adopted largely followed the Basel guidance, with adjustments to reflect local context.

Using audited financial statements for the year 2018, the NBR identified 6 D-SIBs in two categories based on their weights. The first category included one bank and was required to hold a 0.8 percent additional core capital to the 10 percent minimum requirement. The second category included 5 banks, and these were required to maintain 0.5 percent additional core capital. Overall, throughout the previous financial year (2019/18), all the identified D-SIBs met all the capital and liquidity requirements, and even maintained capital buffers above the required minimum.

**Box 1: A methodology to identify and supervise systemically important Banks in Rwanda.**

In line with global trends, and as part of reforms to foster financial stability, the NBR developed and issued a framework for regulation and supervision of Domestically Systemically Important Banks (D-SIBs). The framework specifies the assessment methodology for identifying D-SIBs and additional regulatory requirements for identified D-SIBs. A systemically important bank is defined as a bank whose failure might largely disrupt the functioning of the entire financial system with far reaching impact on the economy. By implementing this policy tool, the NBR aimed at creating stronger risk management practices that would reduce the systemic risk that D-SIBs pose to the financial system.

The methodology adopted in defining D-SIBs follows the Basel guidance, but with adjustments to meet the local context. The methodology ranks banks based on 5 broad indicators: the size, interconnectedness, substitutability, complexity and cross-jurisdictional activities. In implementing this framework, every year, the NBR identifies and communicate D-SIBs to the Banking industry (in June every year). The assessment are based on annually audited financial statements of banks, usually available in April. Identified D-SIBs are required to comply with the specific requirements provided in the framework. For example, they are required to provide, among other things, specific recovery plans and are prioritized in the inspection plans of NBR. The table below describes the indicators used to rank banks.

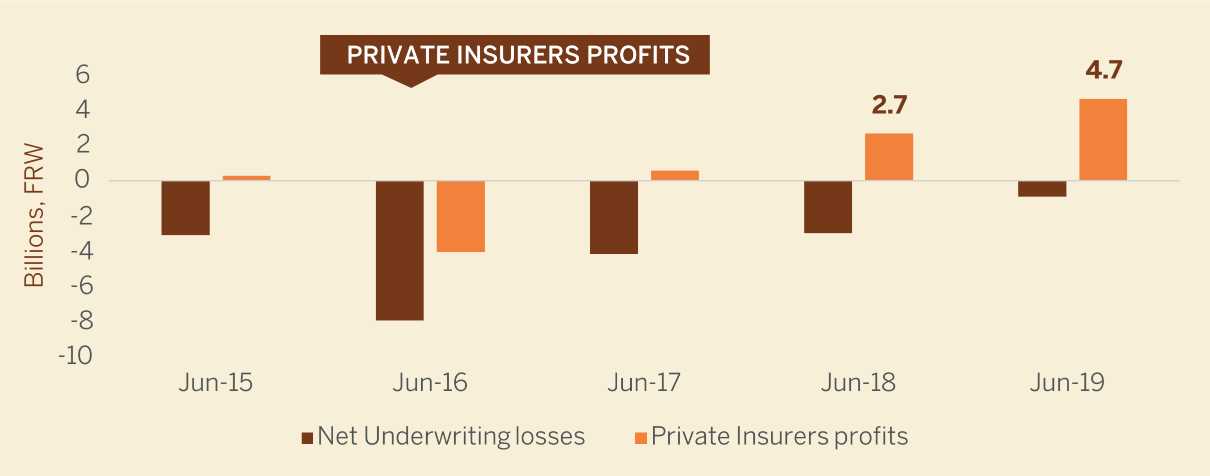
| CATEGORY | WEIGHTS | INDICATORS | SUB-WEIGHTS |
|---|---|---|---|
| **Size** | 35% | Total assets (+ off balance sheet) | 17.50% |
| | | Deposits | 17.50% |
| **Interconnectedness** | 20% | Intra-financial system assets | 6.67% |
| | | Intra-financial system liabilities | 6.67% |
| | | Wholesale funding ratio | 6.67% |
| **Substitutability** | 20% | Assets under custody | 4.00% |
| | | Payments cleared and settled through payment systems | 4.00% |
| | | Branches | 4.00% |
| | | Agents | 4.00% |
| | | ATMs | 2.00% |
| | | POS | 2.00% |
| **Complexity** | 20% | Value of investments in Non-Bank subsidiaries | 6.67% |
| | | Values of listed securities | 6.67% |
| | | Amount held on trust account for e-money issuer. | 6.67% |
| **Cross-border activity** | 5% | Cross jurisdictional claims | 2.5% |
| | | Cross-jurisdictional liabilities | 2.5% |

**The low profitability of private insurers is another risk facing the financial sector.** Although the insurance sector performance has improved in the last three years (2016 to 2019) in all aspects (solvency, liquidity and profitability), several private insurers are still underwriting losses on their key products and most of the profits for most private insurers in the recent past originated from investment income (Figure 8). Low insurance penetration, limited product differentiation, price undercutting, high operating costs and fraud in the claims processes are some of the key challenges facing the insurance sector. The insurance penetration (ratio of total premiums to GDP) stood at 1.7 percent in June 2019, the same in June 2018. This low level of insurance penetration suggests significant scope for insurance expansion. Low penetration also reflects the currently low usage of insurance products and services by the economic agents (households and firms). For example, as at end June 2019, the total insurance policy holders stood at 795,932 (11 percent of the total adult population). The mismatch between insurance products on the market vis a vis the needs of households especially in the rural areas and the informal sector (farming and SMEs), partly explains this low penetration. It is important that insurance companies widen their client base through tailoring their products to the current needs of economic agents. Insurance companies also need to diversify their business that is currently dominated by motor and medical insurance products with 43 percent and 31 percent share of total non-life insurance premiums, respectively.

Recent initiatives to increase the insurance penetration include micro-insurance Regulation published in December 2018 purposely to create conducive environment for micro-insurance business. Micro insurance includes a range of insurance products that cover the low-income segments of the population against specific risks in exchange for regular premium payments proportionate to the likelihood and cost of the risks involved. It is a broad market that, if exploited by insurance companies, can expand their client base, as well as increase insurance penetration.

The other recent initiative expected to increase insurance penetration is the National Agriculture Insurance Scheme. Early this year, the Ministry of Agriculture and Animal Resources (MINAGRI) in partnership with three insurance companies conducted a pilot study of this scheme by providing insurance cover to cooperatives of maize farmers, rice and livestock in 14 districts. Based on the lessons from the pilot, the scheme is expected to be rolled out across the country and is expected to increase insurance penetration as agriculture employs more than 73 percent of adult Rwandans. Other avenues being reviewed to increase insurance penetration include the assessment of where big risks are insured as well as combatting fronting practices in the sector. Continuous assessment of other insurable assets currently not insured and designing appropriate products to cover those risks will be a critical enabler in further increasing insurance penetration going forward.

Figure 8: Private Insurers Profits




Source: **NBR, Financial Stability Directorate**

# PERFORMANCE OF THE FINANCIAL SYSTEM

The growth of the financial sector's assets improved during the period under review on the back of favorable macroeconomic conditions. As at end June 2019, total assets of the financial sector increased by 14 percent (Y-o-Y) to FRW 4,919 billion, against 12 percent registered in the previous year. As a percentage of GDP, total assets of the financial sector increased from 54.2 percent to 56.9 percent. The uptick in growth of financial sector assets benefited from the conducive macroeconomic environment registere in 2018. Improved economic activities increased the debt servicing capacity of borrowers, which subsequently improved the quality of financial sector assets.

**Rwanda's financial sector supports the economy.** It facilitates saving and borrowing, enables risks sharing, facilitates payment among economic agents and enables people to save for future retirement. By virtue of its role, the financial sector is expected to play a direct integral role in Rwanda achieving its medium-term development strategy (2018-2024) embodied in the National Strategy for Transformation (NST1). The financial sector will particularly have direct roles in the economic transformation pillar that includes job creation, sustainable urbanization, increased productivity of agriculture and, promotion of industrialization. The sector has also indirect role to play in the pillar of social transformation through providing the necessary financing of projects that are profitable and developmental.

**For the financial sector to make significant contribution to the economy, it needs to be sound, stable, inclusive, competitive and deep.** In that respect, the NBR is mandated to ensure stability of the financial sector. To help achieve this, the NBR regulates and supervises banks, MFIs insurers, pension funds, the payment system and other financial market infrastructure, as well as other non-deposit taking financial institutions. Although ensuring soundness is NBR's main mandate, it seeks to establish the conducive legal and infrastructure foundation for an inclusive and efficient financial system. The NBR partners with relevant Government and private sector partners to establish financial inclusion strategies aimed at accelerating and measuring financial inclusion. Financial consumer protection is another area that the NBR focuses on through mainly encouraging and enforcing transparency in the financial sector and financially educating the population.

**The financial sector remains dominated by the Banking sector with 66.1 percent total financial system assets as at end June 2019.** The pension fund ranked second with 17 percentage share followed by insurance and microfinance sectors, which accounted for 9.7 percent and 6.4 percent respectively. Following the review of the Pension Law in 2015 and the publication of the Regulation on voluntary pension schemes in 2016, the NBR has so far registered 12 private pension schemes, with assets worth FRW 39.8 billion (0.8 percent of total assets of the financial sector).

**The number of regulated financial institutions reduced from 516 to 500 during the period under review.** The number of insurance companies reduced from 16 to 14 following the merger of SAHAM and SORAS in May 2019. Microfinance institutions reduced from 473 to 457 due to mergers, acquisitions and liquidations. 4 MFIs are under liquidation, 1 MFI license was withdrawn due to non-compliance, 10 MFIs were acquired by UMUTANGUHA PLC and 4 SACCOs were acquired by UMURIMO Finance, while two SACCOs merged into MTG ISHEMA SACCO. On the other hand, the MFI sector registered 3 new entrants during the period under review (AMIFA RWANDA, BRAC MFI and JALI SACCO).

# PERFORMANCE OF THE BANKING SECTOR

The Banking sector is composed of 11 Commercial Banks, 1 Development Bank, 1 Cooperative Bank and 3 Microfinance Banks. All these Banks are regulated under the Banking Law Nº 47/2017 of 23/9/2017 governing the organization of banking.

**Lending remained the main business of Banks. The share of loans in Banks' assets increased from 57.7 percent in June 2018 to 58.8 percent in June 2019.** Government securities represented 10 percent of total assets while cash and reserves at NBR represented 8.9 percent. Investments in other securities 5.3 percent, assets held by other financial institutions 10.1 percent, fixed assets 4.4 percent and other assets 2.4 percent.

**The main earning assets for Banks are loans and investments in Government securities - income from these two accounted for 71.3 percent of total incomes of Banks as at end June 2019.** In the period under review, Banks reduced the share of their holding of Government securities in favor of increased lending to the private sector. The asset structure of Banks imply that credit demand, quality of loans, and interest rate spread determine profits of Banks, which ultimately also determines the solvency positions of Banks.

**Lending picked-up on the back of increased demand for credit.** The outstanding loans of the Banking sector increased by 16.6 percent (Year-on-Year) to FRW 2,008 billion, compared to a 9 percent growth registered in June 2018 (Figure 8B). Demand for loans particularly increased in the first half of 2019, compared to last year, enabling Banks to lend, for example, the volume and value of loan applications increased from 239,629 to 365,129 and from FRW 505.7 billion to FRW 648.6 billion respectively. In line with improved demand for loans, new loans approved by Banks in the first six months of 2019 increased by 36.7 percent (from 402.7 billion to FRW 551.1 billion), compared to the decline of 3.4 percent registered in the first six months of 2018.

**Credit growth particularly increased in transport and communication, water and energy as well as in manufacturing (Table 3).** The growth in the transport and communication sector was largely due to the FRW 50 billion MTN syndicated loan concluded towards the end of 2018. Growth in the water and energy sector was mainly due to the FRW 17.5 billion extended to WASAC to finance its water network extension plan. Lending to manufacturing has consistently increased over the last three years (Table 3) - partly demonstrating Banks' increased financing of the "Made in Rwanda" program. Lending to manufacturing was broad-based in terms of beneficiaries, for example, new manufacturing loans in the first half of 2019 went to 249 firms, compared to 125 firms registered in June 2018, portraying increased demand of loans for manufacturing purposes, as well as, increasing appetite of Banks to lend to this strategic sector.

**Lending also accelerated in agriculture and consumer loans (Table 3).** In agriculture, increased lending reflects good agriculture seasons that enabled farmers to borrow for farming purposes. Consumer loans have also increased for the last three years in row (Table 27), reflecting the increasing uptake of micro-digital loans so far offered by four banks (BK, Equity, KCB and CBA). Banks offer these loans in partnership with telecoms. The size of these loans range between FRW 1,000 to 500,000 and hold a maturity of 1 to 6 months. Since June 2018, the uptake of these loans have increased. The outstanding value of these micro-digital loans increased by 113 percent during the period under review (i.e. from FRW 1.5 billion in June 2018 to FRW 3.2 billion in June 2019).

**Banks' loan portfolio remain concentrated to trade and mortgage sectors, although this slightly reduced in June 2019.** The combined share of mortgage and trade loans in the total banking sector loans stood at 50.3 percent in June 2019, down from 54.3 percent in June 2018 as Banks diversify their lending to manufacturing, consumer loans and communication. The high banking sector exposure to trade and mortgage sectors remains among key risks facing the financial sector. With this structure, shocks to the mortgage sector like fluctuation of housing prices, rental prices and occupancy rates would weigh on the Banking sector performance. On a positive note, the Banking sector is conscious of this risk and have started to diversify by increasing lending to other sectors of the economy (Table 27). Further, to contain risks related to high real estate exposure, the NBR introduced the loan-to-value (LTV) limits on housing properties (details of LTV directive are discussed in section on policy reforms).

Table 3: Banks' Outstanding Loans by Sector

| ACTIVITY SECTOR | LOANS (IN BILLIONS, FRW) | | | ANNUAL CHANGE | |
|---|---|---|---|---|---|
| | JUN-17 | JUN-18 | JUN-19 | % CHANGE 18/17 | % CHANGE 19/18 |
| **Consumer loans** | 121.9 | 137.8 | 160.5 | 13.0 | 16.5 |
| **Agricultural & livestock** | 28.4 | 24.6 | 28.2 | -13.5 | 14.4 |
| **Mining activities** | 1.7 | 3.4 | 3.3 | 104.5 | -2.5 |
| **Manufacturing** | 149.9 | 173.1 | 208.8 | 15.5 | 20.6 |
| **Water & Energy** | 39.6 | 43.2 | 82.6 | 9.1 | 91.2 |
| **Mortgage industries** | 530.8 | 609.0 | 672.6 | 14.7 | 10.4 |
| Public works | 73.5 | 119.2 | 114.0 | 62.2 | -4.4 |
| Residential houses | 251.3 | 259.9 | 295.0 | 3.4 | 13.5 |
| Commercial houses | 206.0 | 229.9 | 263.6 | 11.6 | 14.7 |
| **Trade** | 298.2 | 282.7 | 301.7 | -5.2 | 6.7 |
| **Restaurant & hotel** | 157.0 | 132.9 | 146.2 | -15.4 | 10.0 |
| **Transport & communication** | 134.4 | 161.5 | 249.5 | 20.1 | 54.4 |
| **OFI &Insurance** | 26.1 | 21.5 | 23.6 | -17.6 | 10.0 |
| **Other Service sector** | 50.5 | 54.2 | 52.8 | 7.3 | -2.5 |

Source: **NBR, Financial Stability Directorate**

**Banks continue to rely of stable sources of funds in form of customer deposits. Deposits are mainly from residents (73.7 percent of total deposits).** Global experience indicates that resident deposits constitute stable funds compared to non-resident deposits that are highly sensitive to market sentiments. As at June 2019, interbank and foreign financing represented other sources of financing for Rwandan Banks, at 16.3 and 6.8 percent, respectively. Banks use interbank funds mainly for short-term liquidity management, rather than for investment purposes.

## The Soundness of the Banking Sector

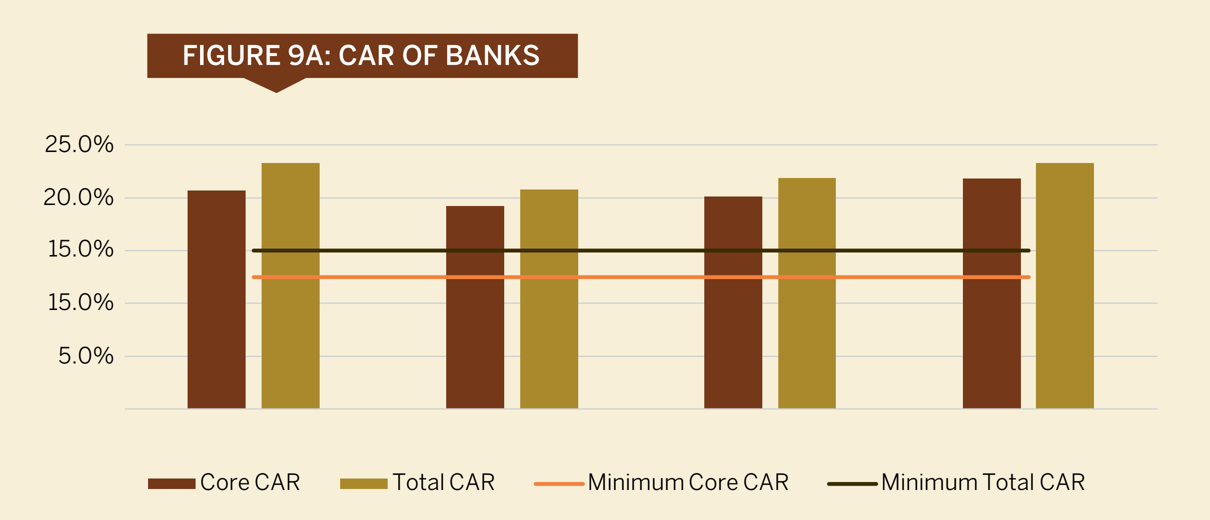
**All banks are solvent and maintain capital buffers above the minimum prudential requirements.** The system-wide total Capital Adequacy Ratio (CAR) increased to 23.3 percent of risk-weighted assets in June 2019, up from 21.9 percent observed in June 2018 (Figure 9A). Banks also maintained high quality capital by holding a high proportion of Common Equity Tier 1 (CET1) in their capital stock. CET1 accounted for 93.7 percent of total banking sector capital in June 2019 (i.e. FRW 496.7 billion out of FRW 530 billion). Banks CET1 is largely composed of paid-up capital, share premiums and retained earnings. Capital is required by Banks to absorb losses that may arise during the normal course of the Bank's operations. All DSIBs met the additional capital charge as at end June 2019 (Figure 9B). The sufficient capital buffer held by Banks therefore indicates the resilience of the financial sector to shocks.

**Capital ratios of Banks were driven-up by capital injections and retained earnings that outmatched growth of risk weighted assets.** During the period under review, the core capital of Banks increased by FRW 90 billion (from FRW 407 billion in June 2018 to FRW 497 billion in June 2019). This growth is largely attributable to fresh capital injection and retained reserves.

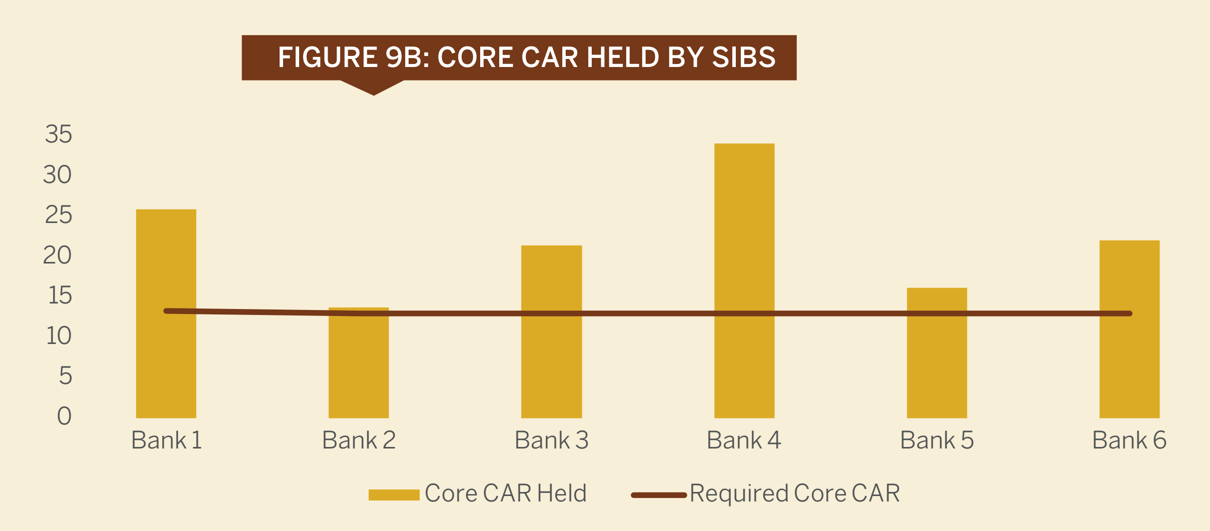
**Banks are expected to increase their capital base in the next five years in line with the new licensing requirements.** In December 2018, the NBR increased the minimum paid-up capital requirements for different categories of Banks - Commercial Banks from FRW 5 billion to FRW 20 billion and Development Banks from FRW 3 billion to FRW 50 billion.

The minimum paid up capital for Cooperative and Mortgage Banks was set at FRW 10 Billion. Banks have a five-year transition period ending 2023 to comply with the new requirements while new entrants will be required to meet the minimum capital requirements at the licensing stage.

Figure 9: Capital Adequacy Ratio (CAR) of Banks



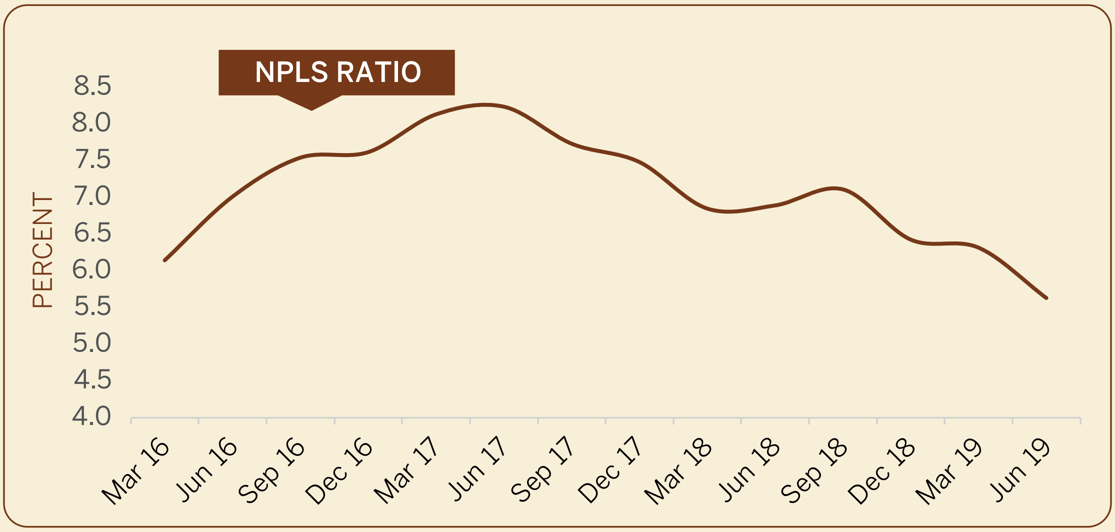

Source: **NBR, Financial Stability Directorate**




Source: **NBR, Financial Stability Directorate**

**With regard to asset quality, the Non-Performing Loans (NPLs) ratio of Banks, has steadily dropped since September 2017 (Figure 10) implying a reduction in the proportion of bad loans to total loans.** The NPLs ratio is a key financial stability indicator as it affects profits, solvency and liquidity of Banks. The steady reduction of the NPLs ratio observed since September 2017, when it reached a pick of 8.2 percent, is a result of the write-offs done by Banks - total write-offs by Banks amounted to FRW 29 billion in the first six months of 2019. In addition, the improved economic performance resulted in increased revenues for borrowers and thereby their ability to meet debt service commitments as well as an uptick in demand for new loans resulting in new lending.

Figure 10: Banking Sector NPLs Ratio




Source: **Financial Stability Directorate**

**The NPLs ratio particularly dropped in agriculture, manufacturing, mortgage and hotels (Table 4).** In agriculture, the reduction of NPLs was supported by the improved performance of the sector during the period under review. A good agriculture season supported farmers to borrow from Banks, as well as, service their loans. The significant reduction of NPLs ratio in the manufacturing sector as well as mortgage and hotels was mainly due to write-offs as well as increased new lending to this sector. The NPLs ratio also dropped in the consumer loans category, water and energy sector and in transport and communication mainly reflecting increased lending to these sectors during the first half of 2019.

**Banks' asset quality deteriorated in trade and mining (Table 4).** In mining, the trend in NPLs reflects the slowdown of international commodity prices that affected the export revenue from minerals in the first half of 2019.

Due to unfavorable international prices, Rwanda's mineral export values decreased by 22.8 percent (Y-o-Y) in H1 2019, compared to 50.1 percent growth registered in H1 2018. The slowdown of commodity prices, not only affected export revenues, but also affected the performance of mining loans. The total amount of NPLs in mining increased from FRW 22 million in June 2018 to FRW 2.9 billion. Nevertheless, mining accounts for a small share of banking sector loans (2 percent as at end June 2019) and hence its bad performance did not weigh-up the overall banking sector NPLs ratio. In trade, NPLs were driven by the poor performance of four large loan facilities in two Banks amounting to FRW 15.3 billion. The increasing NPLs in the trade sector since June 2016 (Table 4) is among the key risks facing the Banking sector as this sector accounts for the second largest share of banking sector loans (at 15.6 percent), after mortgage (at 34.9 percent).

Table 4: Sectoral NPLs Ratio

| ACTIVITY SECTORS | JUN-16 | JUN-17 | JUN-18 | JUN-19 |
|---|---|---|---|---|
| **Personal loans** | 6.4 | 7.8 | 6.1 | 6.0 |
| **Agriculture** | 16.9 | 18.2 | 7.2 | 5.0 |
| **Mining activities** | 0.9 | 0 | 0.6 | 88.4 |
| **Manufacturing** | 6 | 8.8 | 13.9 | 1.3 |
| **Water & Energy** | 0.2 | 0.1 | 0.0 | 0.0 |
| **Mortgage industries** | 5.1 | 5.8 | 5.3 | 4.0 |
| **Trade** | 6.9 | 8.8 | 11.5 | 15.0 |
| **Hotels** | 9 | 9.8 | 11 | 8.8 |
| **Transport & Communication** | 3.1 | 3 | 2.6 | 1.9 |
| **OFI & Insurance** | 4.2 | 0.4 | 0.4 | 1.7 |
| **Other services** | 4.5 | 10.7 | 8.9 | 6.7 |

Source: **NBR, Financial Stability Directorate**

One of the measures to reduce the NPLs is through enhancing the credit information system. The details of the CIS performance in Rwanda are elaborated in the Box 2 below:

**BOX 2: Credit Reporting System Performance**

The NBR oversees the Credit Reporting System (CRS) that includes the private credit reference bureau (TransUnion), the credit data providers (this includes all regulated financial institutions, utilities, Rwanda Revenue Authority (RRA) and other voluntary data providers). NBR believes credit reporting systems are vital to strengthening financial infrastructure and ultimately support access to finance by providing lenders with objective information that enables them to reduce their portfolio risk, reduce transaction costs, and expand their lending portfolios.

The Credit reporting system in Rwanda is composed of one private credit reference bureau (TransUnion), 499 credit-reporting institutions (this includes 17 banks, 12 insurance companies, 455 microfinance institutions, 2 telecoms, 1 utility company and 12 voluntary data providers).

Data providers include mandatory providers, those who are mandated by law to provide information to the bureau and voluntary data provider's -those that voluntarily report to the bureau. The bureau (TansUnion) process and validates data in consultation with data providers, before storing it, and subsequently sharing it with permissible users in-form of credit reports and credit scores. Each data subject (people and firms) is allowed one free credit report by the credit reference bureau each year, to enable him/her a chance to validate his/her credit status. In 2018, TransUnion introduced a mobile solution (Menyesha) that enables people easier access to their credit report in real time using their mobile phones. By Menyesha, a person simply texts his/her ID to 2272 and gets his/her credit report. Through this implied access, people are able to crosscheck and act to improve their credit score.

The NBR established a legal framework to support the development and efficiency of the credit reporting system. The credit reporting system law (Law Nº73/2018 of 31/08/2018 Governing Credit Reporting System) and implementing regulation were revised in 2019 to comply with international standards (the General Principles for Credit Reporting System established by the World Bank). The law and implementing regulation Nº 27/2019 of 09/09/2019 relating to Credit Reporting System provide guidance on (1) the kinds of data that can be collected and the permissible purposes for which it may be shared, (2) establishes consumer rights, (3) provides guidance on data security obligations, data retention periods, and other compliance matters, and (4) governance arrangements of credit reporting data providers and credit reporting service providers.

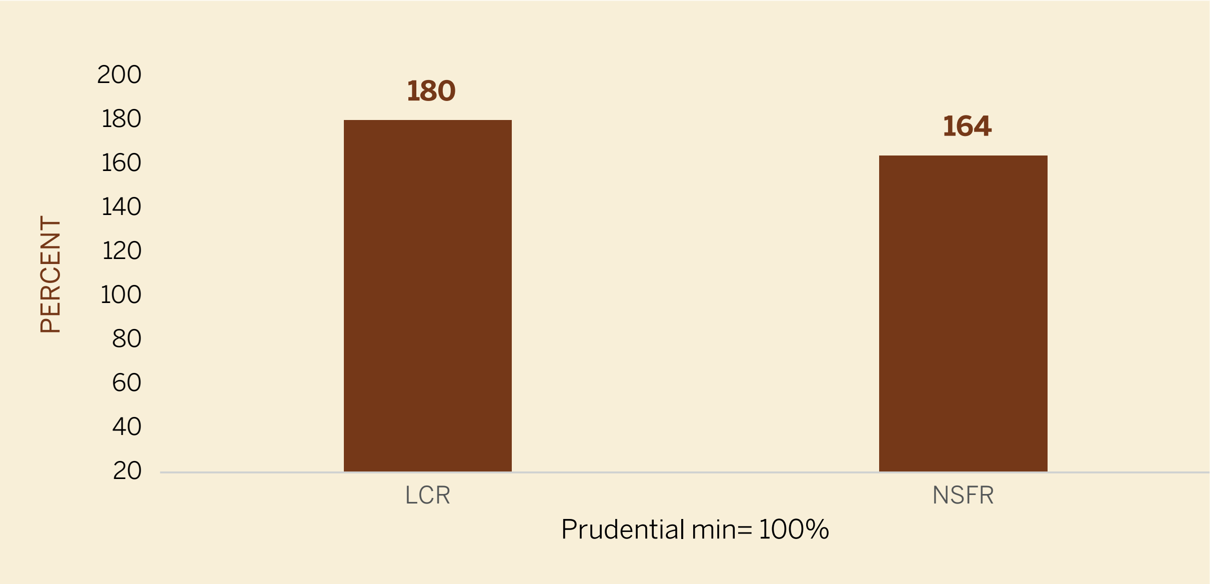
The World Bank Doing Business report for 2019 assessed the credit reporting system in Rwanda as deep and supportive of lending decisions. Rwanda scored the maximum 8 points of the doing business points on depth of the credit information system, higher than Sub-Saharan Africa average at 3.9 points. The World Bank Doing Business Report commends the rules and practices governing coverage, scope and accessibility of credit information system. According to the World Bank methodology, Rwanda's high score on credit information depth was based on 5 principles:

1. The fact that the credit reference bureau collects and keeps both positive credit information (for example, original loan amounts, outstanding loan amounts and a pattern of on-time repayments) and negative information (for example, late payments and the number and amount of defaults).
2. The credit reference bureau compiles data from also utility companies, in addition to data from regulated financial institutions.
3. The credit reference bureau is supposed to retain data up to 5 years from the final date for payment. This means credit bureaus are not allowed to erase data on defaults as soon as they are repaid or distribute negative information for more than 5 years from the date of final settlement of the amount in default.
4. By law, borrowers have the right to access their data in the largest credit bureau or registry in the economy.
5. Banks and other financial institutions have online access to the credit information (for example, through a web interface, a system-to-system connection or both). Rwanda compares favorably to Sub- Saharan Africa (SSA) average on Credit bureau coverage. The World Bank Doing Business Report (2019) indicated that credit bureau coverage in Rwanda at 23.8 percent is higher than the average for SSA at 11.0 percent, but lower than average for OECD countries at 66.7 percent. The NBR aims to work with all players in the CRS ecosystem to increase the credit bureau coverage by on boarding the non-financial institutions data from retailers, Government agencies and other voluntary providers of data relevant for credit bureaus.

**Banks' loan-loss coverage ratio increased from 67.4 percent in June 2018 to 80.2 percent in June 2019.** In nominal value, Banks' provisions increased from FRW 92.8 billion in June 2018 to FRW 100.6 billion in June 2019.The loan loss provision coverage ratio is an indicator of how protected a bank is against future losses. A higher ratio therefore means that Banks can withstand future losses better, including unexpected losses. The provisions of Banks are expected to increase further during the next 5 years as Banks implement the IFRS9 related provisions. Banks adopted IFRS9 in December 2018, although the NBR guideline allows Banks to spread their outstanding IFRS9 day one provisions over five years (i.e., 2018-2023).

**The Banking sector remains adequately liquid.** The Liquidity Coverage Ratio (LCR), that indicates the proportion of Banks' highly liquid assets to their short-term obligations stood at 180.5 percent as at end June 2019, against 100 percent minimum prudential requirement (Figure 11). Similarly, the aggregate Net Stable Funding Ratio (NSFR), that relates the Banks long-term assets to long-term liabilities stood at 164.3 percent at end June 2019 against 100 percent minimum prudential requirement. The high NSFR reflects the structure of banking sector liabilities that are largely composed of client deposits. The stress test performed on LCR suggests that Rwandan banks are resilient to an abrupt withdrawal of 10 percent of institutional investors' deposits and a simultaneous dry of 5 percent inflows from loans repayments. This shock, when if it happened in one month would leave only two banks under the LCR requirements with the total LCR reducing from 180.5 percent to 150.1 percent. The NBR implemented the two-liquidity standard (LCR and NSFR) in 2018 as part of the broader reforms to comply with international regulatory standards (Basel III).

Figure 11: Banking Sector Liquidity Position



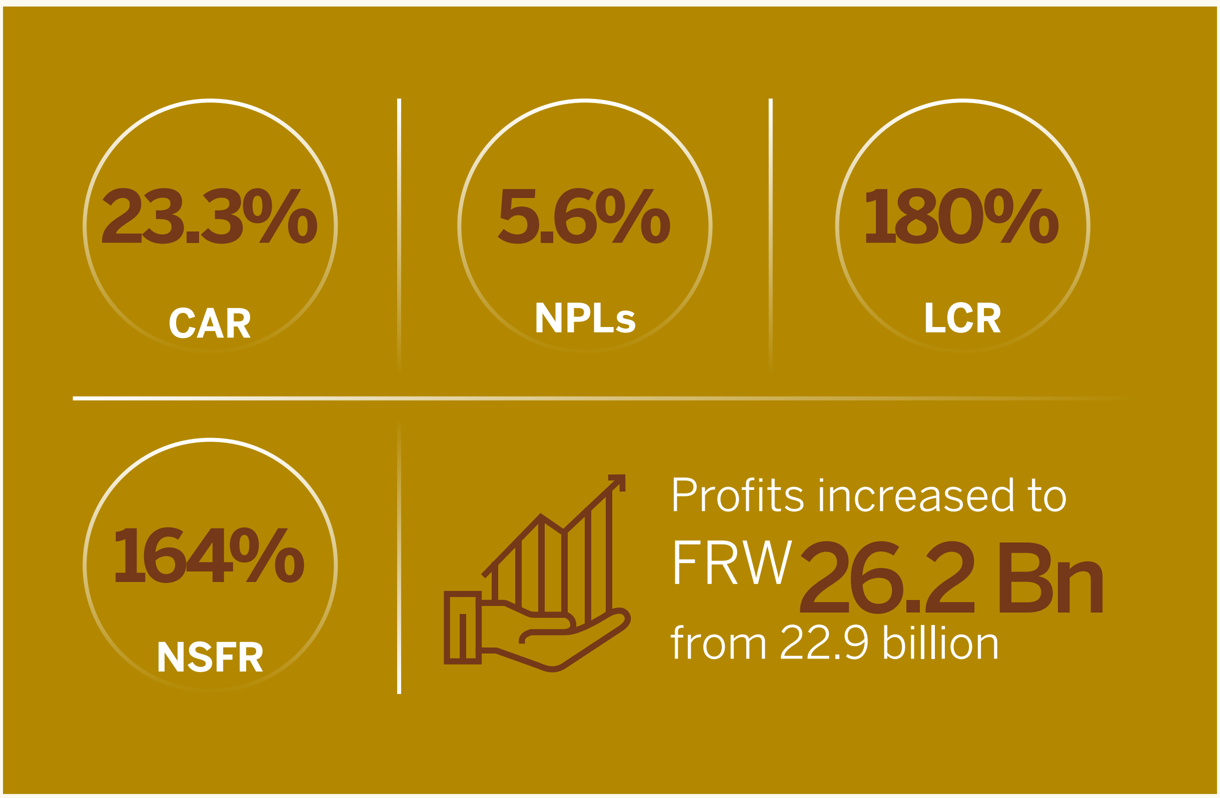

Source: **NBR, Financial Stability Directorate**

**The Banking sector profits picked-up as income expanded more, in absolute terms, than expenses.** The net profits of Banks increased to FRW 26.2 billion in H1 2019 from FRW 22.9 in H1 2018. The improvement in banking sector profits is associated with 14.3 percent increase in income from FRW 195.7 billion in H1 2018 to FRW 223.7 billion in H1 2029, which offset the 14.3 percent growth of expenses from FRW 158.7 billion in H1 2018 to FRW 181.4 billion in H1 2019. Increasing profits of the Banking sector supports its stability by increasing its capital base through retained earnings.

**Banks' profits were largely driven-up by Net Interest Income (NII).** The total banking industry NII increased by FRW 20.6 billion during the period under review (i.e. from FRW 99.6 billion in H1 2018 to FRW 120.2 billion in H1 2019). Banks generate interest income from loans (at 85.3 percent of total interest income), Government securities (9.4 percent) and placements & other market securities (5.3 percent).

Banks' NII in H1 2019 was weighed-up by the slowdown of interest expenses and increased volume of loans which increase interest income. The slowdown of Interest expenses is attributed to the reduced growth of term deposits and a decline of cost of funds.

**Profits of Banks were also weighed-up by non-interest income that increased by FRW 5.6 billion (from FRW 49.7 billion in June 2018 to FRW 55.3 billion in June 2019) largely due to recoveries.** A breakdown of non-interest income of Banks indicates that during the period under review, recoveries increased the most by FRW 4 billion indicating Banks' efforts in recovery of NPLs and previously written-off loans, but also the positive impact of the economic performance that enables economic agents (individuals and firms) to service their debt. Fees and commissions increased by FRW 1.3 billion, off-balance sheet income by 0.5 billion, while foreign exchange income dropped by FRW 0.2 billion. It is worth noting, though, that non-interest income only represents 25 percent of Banks' total income as at end June 2019 indicating overreliance on lending for revenue generation.



# MICROFINANCE SECTOR

**The microfinance sector is composed of 457 institutions as at end June 2019.** This includes 19 limited MFIs, 438 Credit SACCOs (416 Umurenge SACCOs and 22 non U-SACCOs). Compared to Banks, MFIs are spread across the country, including rural areas, which facilitates access to finance for unbanked population, especially rural households and micro SMEs. As at end June 2019, the total clients of MFIs amounted to 3,772,503 (i.e., 54 percent of the total adult population). In terms of products, MFIs mainly offer loans and saving products to their clients.

## Performance of Microfinance Sector

**The balance sheet of the microfinance sub-sector continued to expand during the year ended June 2019.** Total assets of this sub-sector increased by FRW 34 billion (i.e. from FRW 279 billion in June 2018 to 313 billion in June 2019). Growth happened to all MFI sub-sectors as follows: Assets of U-SACCOs increased by FRW 10.4 billion to FRW 138.4 billion, assets of limited MFIs increased by 16.7 billion to FRW 85.6 billion, while assets of other non U-SACCOs increased by FRW 6.9 billion to FRW 89.1 billion.

**The earning assets of MFIs increased by FRW 20.1 billion to FRW 165.3 billion during the period under review.** Earning assets of MFIs include loans, placements in Banks, and investments in Government securities. In the year to end June 2019, the MFIs sub-sector loans increased by 18.3 billion to FRW 161.9 billion, while the stock of MFIs' investment in Government securities and placements in Banks increased by FRW 193.7 million. MFIs sector earning assets (altogether) accounted for 52 percent of MFI sector assets, with the rest being un-earning like cash and current account deposits in Banks. This structure of MFI assets (large size of un-earning assets) reflects the still limited financial intermediation performed by MFI. Low intermediation largely relates to few feasible and financeable projects, especially in rural areas. The MFI sector is expected to benefit from the on-going Government initiative to de-risk the agriculture sector, through increased financeable projects.

**Nevertheless, lending to agriculture picked up during the period under review.** The stock of loan in agriculture sector increased by 244 percent from FRW 21.5 billion in June 2018 to FRW 73.8 billion in June 2019. This growth is much stronger than the growth the growth of 3.3 percent registered in June 2018. Reflecting this growth, the share of agricultural loans in total MFIs increased to 44.2 percent in June 2019 from 14.4 percent in June 2018, making the agriculture sector the most financed sector by MFIs ahead of trade (at 26.4 percent) and mortgage (at 10.3 percent). The improved lending in agriculture sector reflects increased demand and improved assets quality in this sector following series of good agriculture performance.

Lending also rebounded in trade sector. During the period under review, the outstanding loans in trade sector increased by 7.2 percent from FRW 41.2 billion in June to FRW 44.2 billion in June 2019, after a decline of 17.9 percent in June 2018. However, this growth is lower compared to the average growth of 20 percent that was observed between 2016 and 2017. Financing of mortgage continued to decline. The stock of loans in mortgage sector reduced by 51 percent from FRW 35.4 billion in June 2018 to FRW 17.2 billion in June 2019, in addition to a decline of 10.2 percent observed in June 2018. The decline of lending in mortgage sector reflects increased write offs and reduced new lending in the wake of perceived risks by MFIs.

**Growth of MFI assets reflects increased funding during the period under review.** Deposits, the main source of funds for MFIs, increased by FRW 13.6 billion to FRW 167 billion during the year ended June 2019. During the same period, equity (including paid-up, retained earnings and other equity) increased by FRW 11.5 billion to FRW 99 billion. Borrowing and line of credit account for a small portion of MFI funding (6 percent) and increased by FRW 1.2 billion during the period under review. MFIs, especially Ltd MFIs borrow occasionally from Banks.

**Similar to Banks, the challenge of short-term funding constrains the MFI sector on long-term lending.** Saving and term deposits accounted for only 32 percent of total deposits of the MFI sector (i.e., FRW 53.5 billion out of FRW 167.2 billion total deposits).
The share of term and saving deposits is even lower for the U-SACCO subcategory at 13 percent (i.e. FRW 9.4 billion out of FRW 7.3 billion). For MFI to provide long-term developmental loans, they need long-term financing. The NBR's approach to this challenge has been through financial education.

## The Soundness of Microfinance Sector

**The MFIs sub-sector remains solvent and liquid.** As at June 2019, the CAR , the measure of solvency, stood at 33.9 percent, above the minimum regulatory requirement of 15 percent. The solvency buffer held by MFIs portray the resiliency and capacity of the sector to withstand shocks. The MFIs sector hold sufficient liquid assets and liquidity risks are very minimal. The liquidity ratio of the MFI sector stood at 108.8 percent at end June 2019, significantly above the prudential limit of 30 percent. The overly high liquidity position of MFIs relate to the still limited investment opportunities of these institutions.

**Asset quality of MFIs improved with the overall ratio of non-performing loans to total loans dropping from 7.9 percent in June 2018 to 6.5 percent in June 2019.** In absolute amount NPLs of MFIs dropped by FRW 900 million (i.e. from FRW 11.8 billion in June 2018 to 10.9 billion in June 2019). The NPLs ratio dropped across the three sub-categories of the microfinance sector as follows: In limited liability MFIs, it dropped from 8.7 percent to 5.2 percent. In U-SACCOs, it dropped from 12.3 percent to 12 percent. In other SACCOs, it dropped from 4.2 percent to 3.7 percent.

**The decline of non-performing loans in U-SACCOs largely reflects positive results of the loan recovery mechanism established by Government in October 2018.** A national taskforce composed of four ministries (MINECOFIN, MINECOM, MINALOC and MINIJUST) and six institutions (NBR RIB, RNP, Prosecutor General, and RCA) was established in October 2018 to enforce loan recovery in U-SACCOs. The task force managed to recover FRW 2.7 billion during the first five months of operations (i.e., November 2018-March 2019). The amount-recovered did not reduce U-SACCOs NPLs in similar proportions and these involved mostly written-off loans. Instead, it largely affected profits of U-SACCOs through reduced provisions. The second phase of the taskforce that started in August 2019 is expected to increase further recovery in U-SACCOs.

**Profits of the microfinance sector more than doubled from FRW 3.3 billion in H1 2018 to FRW 7.3 billion in H1 2019.** During the same period, the MFI sector ROA and ROE increased from 2.4 percent and 7.4 percent respectively to 4.6 percent and 13.8 percent. Profits rebounded in all MFI sub-categories. The limited liability MFIs recovered from a loss of FRW 653.3 million in H1 2018 to a profit of FRW 1.5 billion in H1 2019. Profits of U-SACCOs increased by FRW 1.1 billion (from FRW 1.8 in H1 2018 to FRW 2.9 in H1 2019). Profits of other non-USACCOs increased by FRW 420 million (from FRW 2.1 billion in H1 2018 to FRW 2.5 billion in H1 2019). Overall, the improved performance of the economy supported the reduction of NPLs in the microfinance sector. More particularly the good agriculture performance that supported farmers to service their loans. The reduction of NPLs has also supported profits of MFIs.

Table 5: Performance Indicators of MFIs

| INDICATORS | JUN-15 | JUN-16 | JUN-17 | JUN-18 | JUN-19 |
|---|---|---|---|---|---|
| **Assets (FRW billion)** | 187.5 | 230.3 | 247.7 | 283.1 | 313.2 |
| **Loans (FRW billion)** | 93.6 | 119.5 | 127.4 | 142.9 | 167.7 |
| **Deposits (FRW billion)** | 104.9 | 126 | 133.4 | 156.1 | 167.3 |
| **Equity (FRW billion)** | 58.8 | 69.7 | 82.5 | 91.9 | 106.2 |
| **Net profit/Loss (FRW billion)** | 3.4 | 4.3 | -0.1 | 3.3 | 7.2 |
| **Capital Adequacy Ratio (%)** | 31.4 | 30.3 | 33.3 | 32.5 | 33.9 |
| **NPLs / Gross Loans (%)** | 7.4 | 7.5 | 12.3 | 8.0 | 6.5 |
| **ROA ( % )** | 3.9 | 4 | -0.1 | 2.4 | 4.6 |
| **ROE ( % )** | 12.6 | 13.3 | -0.3 | 7.4 | 13.8 |
| **Liquidity ratio ( % )** | 95.4 | 95.1 | 99.1 | 103.3 | 108.8 |

Source: **NBR, Financial Stability Directorate**

# INSURANCE SECTOR

## Structure of the Insurance Sector

**The insurance sector is an integral component of Rwanda's financial system.** It is the third largest component of the financial sector, after banking and the public pension fund. This sector supports the economy by providing risk mitigation mechanisms for households and firms as well as supporting financing from investment of funds mobilized from policyholders. Its growth and performance is therefore critical for economic growth and development. The NBR regulates and supervises the insurance sector to ensure its stability and soundness. Sections below summarize the performance of this sector as at end June 2019.

**The insurance sector consisted of 14 insurance companies as at June 2019.** This includes 12 private Insurers (9 non-life and 3 life Insurers) and 2 public Medical Insurers (RSSB Medical and MMI). The number of Insurers dropped by 2 reflecting the merger of SAHAM and SORAS in May 2019 (SAHAM Vie merged with SORAS Vie, while SAHAM Assurance General merged with SORAS Assurance General). The four Insurers that merged held a combined market share of 19.8 percent of the total insurance sector in December 2018. Insurance intermediaries consisted of 707 agents, 17 brokers, and 19 loss adjusters as at June 2019 from 581 agents, 16 brokers and 13 loss adjusters as at June 2018.

**Low insurance penetration, limited product differentiation, price undercutting, high operating costs and fraud in the claims processes are some of the key challenges facing the insurance sector.** The insurance penetration (ratio of total premiums to GDP) stood at 1.7 percent in June 2019, the same in June 2018. This low level of insurance penetration suggests significant scope for insurance expansion. Low penetration also reflects the current low usage of insurance products and services by the economic agents (households and firms). For example, as at end June 2019, the total insurance policy holders stood at 795,93 (11 percent of the total adult population). The mismatch between insurance products on the market vis a vis the needs of households especially in the rural areas and the informal sector (farming and SMEs), partly explains this low penetration. It is important that insurance companies widen their client base through tailoring their products to the current needs of economic agents.

Insurance companies also need to diversify their business that is currently dominated by motor and health insurance products with 43 percent and 31 percent share of total non-life insurance premiums, respectively. Recent initiatives to increase the insurance penetration include micro-insurance regulation published in December 2018 purposely to create conducive environment for micro-insurance business. Micro insurance includes a range of insurance products that cover the low-income segments of the population against specific risks in exchange for regular premium payments proportionate to the likelihood and cost of the risks involved. It is a broad market that, if exploited by insurance companies, can expand their client base, as well as increase insurance penetration.

**The other recent initiative expected to increase insurance penetration is the National Agriculture Insurance Scheme.** Early this year, the Ministry of Agriculture and Animal Resources (MINAGRI) in partnership with three insurance companies conducted a pilot of this scheme by providing insurance cover to cooperatives of farmers of maize, rice and livestock in 14 districts. Based on the lessons from the pilot, the scheme is expected to be rolled out across the country and is expected to increase insurance penetration as agriculture employs more than 73 percent of adult Rwandans. Other avenues being reviewed to increase insurance penetration include the assessment of where big risks are insured as well as combatting fronting practices in the sector. Continuous assessment of other insurable assets currently not insured and designing appropriate products to cover those risks will be a critical enabler in further increasing insurance penetration going forward.

**During the period under review, total assets of the insurance sector increased by FRW 54.3 billion to FRW 477.3 billion (5.6 percent of GDP).** Assets of public Insurers (RSSB-Medical and MMI) registered the highest increase by FRW 37.4 billion, compared FRW 16.9 billion for private Insurers. Assets of the insurance sector were boosted by capital injections (FRW 4.3 billion) and retained earnings (FRW 50 billion).

**Asset allocation of insurance companies remained stable, as in previous years.** Deposits in Banks remained the largest portion of the Insurers' assets (39 percent), followed by government securities (19 percent), equities (12 percent), properties (10 percent) and other assets with a share of 20 percent. It is worth noting that the asset mix of insurers varies with the class of business.

Whereas short term insurers (non-life – including public insurers) held most of their assets in short term maturities of bank deposits (41 percent), loans and receivables (24 percent), securities and equities (19 percent) and investment in property (8 percent), long term insurers (life) held their assets more in longer term maturities – securities and equities 48 percent, investment in properties (27 percent) and bank deposits (18 percent).

During the period under review, Insurers increased their holdings of Government securities from 16 percent to 19 percent while deposits in Banks reduced (from 47 percent to 39 percent). Insurers' substitution of deposits with Government securities reflects Government's increased issuance of long-term, risk free, securities during the period under review.

Table 6: Asset Mix of Insurers

| DESCRIPTION (% SHARE) | PRIVATE LIFE INSURERS | | | PRIVATE NON-LIFE INSURERS | | | PRIVATE MEDICAL INSURERS | | |
|---|---|---|---|---|---|---|---|---|---|
| | JUN-17 | JUN-18 | JUN-19 | JUN-17 | JUN-18 | JUN-19 | JUN-17 | JUN-18 | JUN-19 |
| Placements in banks to total assets | 39 | 41 | 18 | 36 | 34 | 31 | 54 | 56 | 46 |
| Government securities to total assets | 8 | 13 | 41 | 14 | 14 | 16 | 12 | 14 | 17 |
| Equities to total assets (≤ 30%) | 10 | 9 | 7 | 9 | 9 | 8 | 15 | 15 | 15 |
| Properties to total assets (≤ 30%) | 33 | 28 | 27 | 13 | 12 | 13 | 6 | 6 | 5 |
| Receivables to total assets | 2 | 3 | 3 | 9 | 10 | 14 | 6 | 5 | 13 |
| Property and equipment to total assets | 3 | 3 | 2 | 7 | 6 | 2 | 6 | 4 | 4 |
| Other assets to total assets | 4 | 4 | 2 | 11 | 16 | 16 | 0.2 | 0.1 | 0.1 |

Source: **NBR, Financial Stability Directorate**

**Growth of the insurance sector's premiums improved during the period under review.** Total premiums registered by Insurers increased by FRW 9.1 billion (i.e., from FRW 64.3 billion in H1 2018 to FRW 73.4 billion in H1 2019), higher than the FRW 4.6 billion growth registered in the corresponding period of the previous year. Growth was higher among public insurers (MMI and RSBB-Medical) by FRW 6 billion (from FRW 32.6 billion in H1 2018 to FRW 26.6 billion in H1 2019), compared to private Insurers with premium growth of FRW 3.3 billion (from FRW 37.7 billion in H1 2018 to FRW 40.9 billion in H1 2019). For public insurers, the increased number of subscribers drove the growth of premiums from 432,450 in H1 2018 to 498,289 in H1 2019.

For private insurers, the uptick in premiums reflected the continued impact of the upward revision of motor insurance premiums. Motor and medical insurance premiums accounted for 61 percent of total premiums (FRW 25 billion out of 40.9 billion) registered by private Insurers in H1 2019 and 74 percent of total non-life insurance premiums. The remaining 39 percent of private Insurers' premiums came from property (7 percent), guarantees (4 percent), engineering (3 percent), accident and health (2 percent), transportation (1 percent), liability (2 percent), other non-life insurance products (3 percent) and life insurance products (17 percent).

Profits of the insurance sector (public + private) increased as growth of premiums outmatched that of claims and other operational expenses. The consolidated net profits of Insurers (public and private) increased by FRW 2.4 billion (from FRW 20.8 billion in H1 2018 to FRW 23.2 billion in H1 2019). Improved profits are attributable to higher growth of premiums (+FRW 9.2 billion) compared to claims (+FRW 2.9billion) and operational expenses (+ FRW 2.2 billion). Reflecting growth dynamics of premiums and expenses in H1 2019, the combined ratio (claims ratio+ expense ratio), that measures the operational underwriting profitability of Insurers dropped from 86 percent in June 2018 to 85 percent in June 2019 and remains below the 90 percent prudential maximum.

Profits of private insurers improved over the last four years from a loss of FRW 4.1 billion in June 2016, to a profit of FRW 2.7 billion and FRW 4.7 billion in June 2018 and June 2019 respectively. This steady improvement has been underpinned by a combination of revised premium rates on motor insurance and improved claims management that has gradually reduced the underwriting losses of private Insurers. Profits of private Insurers have been also supported by a steady growth of investment income. As at end June 2019, private Insurers (altogether), held FRW 130.8 billion of investments in different instruments (Government securities, equities, properties and placements in Banks). Investment income of private Insurers increased from FRW 6.1 billion in H1 2018 to FRW 7 billion in 2019.

To improve their profits further, insurers need to appropriately price risks, diversify their insurance products (especially the untapped sectors and segments of the population), as well as put in place controls to reduce fraud. In support of these interventions, the NBR in 2016 issued a directive on conduct of insurance business that required, among other things, Insurers to put in place underwriting and pricing policies forbidding Insurers to sell insurance on credit.

Table 7: Key Profitability Metrics of Insurers

| KEY RATIOS (%) | INSURANCE SECTOR | | | PRIVATE NON-LIFE INSURERS | | | PRIVATE LIFE INSURERS | | | PUBLIC MEDICAL INSURERS | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | JUN-17 | JUN-18 | JUN-19 | JUN-17 | JUN-18 | JUN-19 | JUN-17 | JUN-18 | JUN-19 | JUN-17 | JUN-18 | JUN-19 |
| Claims ratio (max.60%) | 59 | 59 | 57 | 71 | 60 | 55 | 66 | 80 | 88 | 48 | 55 | 52 |
| Expenses ratio (max. 30%) | 28 | 27 | 28 | 41 | 47 | 42 | 47 | 46 | 37 | 11 | 10 | 15 |
| Combined ratio (max.90%) | 87 | 86 | 85 | 112 | 106 | 97 | 113 | 126 | 125 | 59 | 65 | 66 |
| ROE (min.16%)-Annualized | 14 | 16 | 13 | 2 | 12 | 19 | 14 | 0 | 7 | 16 | 17 | 12 |
| ROA (min.4%)-Annualized | 10 | 12 | 10 | 1 | 5 | 7 | 2 | 0 | 1 | 16 | 17 | 12 |

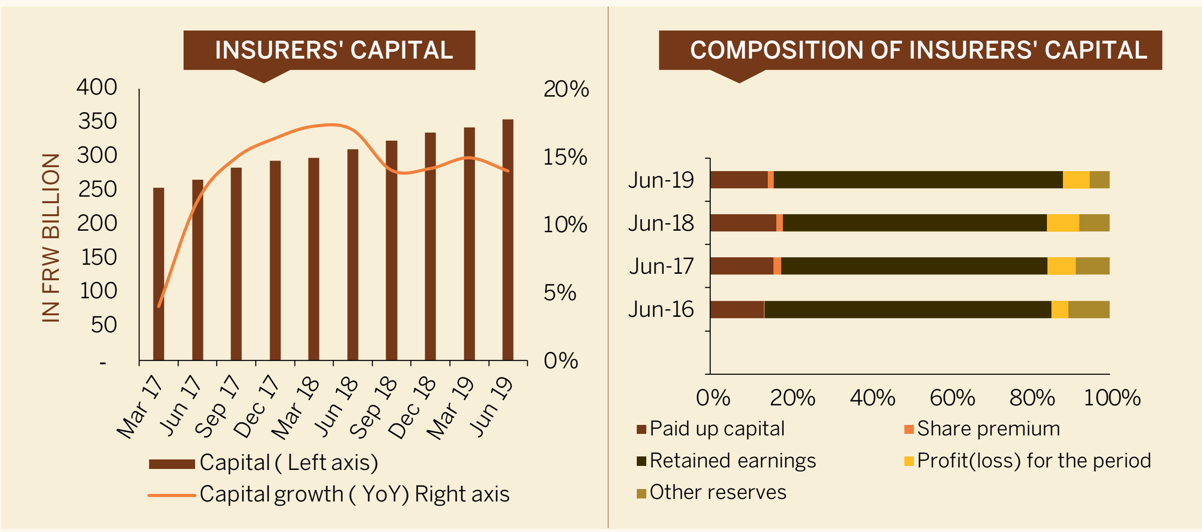
Source: **NBR, Financial Stability Directorate**

Private Insurers solvency level, a measure of the strength of Insurers' capital buffers held to cover all liabilities, improved to 174 percent in June 2019, compared to 149 percent in June 2018, and 100 percent prudential minimum. From a long-term perspective, solvency of private Insurers progressively improved for -53 percent in June 2016, to 61 percent in June 2017 and 149 percent in June 2018. During the period under review, solvency of private Insurers was boosted by net profit (FRW 4.7), as well as, capital injections (FRW 4.3 billion). The solvency position of public Insurers has consistently been high reflecting their stable and profitable business.

As at June 2019, the solvency ratio of public Insurers stood at 2,297 percent, significantly above the 100 percent prudential minimum (Figure 12).

The insurance sector holds adequate liquidity to meet their obligations (claims and other expenses). As at end June 2019, the liquidity ratio of private Insurers stood at 125 percent, above 120 percent minimum prudential requirements (Figure 13). During the same period, the liquidity position of public insurers stood at 4,058 percent.

Figure 12: Capital of Insurers




Solvency position of private insurers improved significantly, while public insurers' solvency position remains highly adequate.

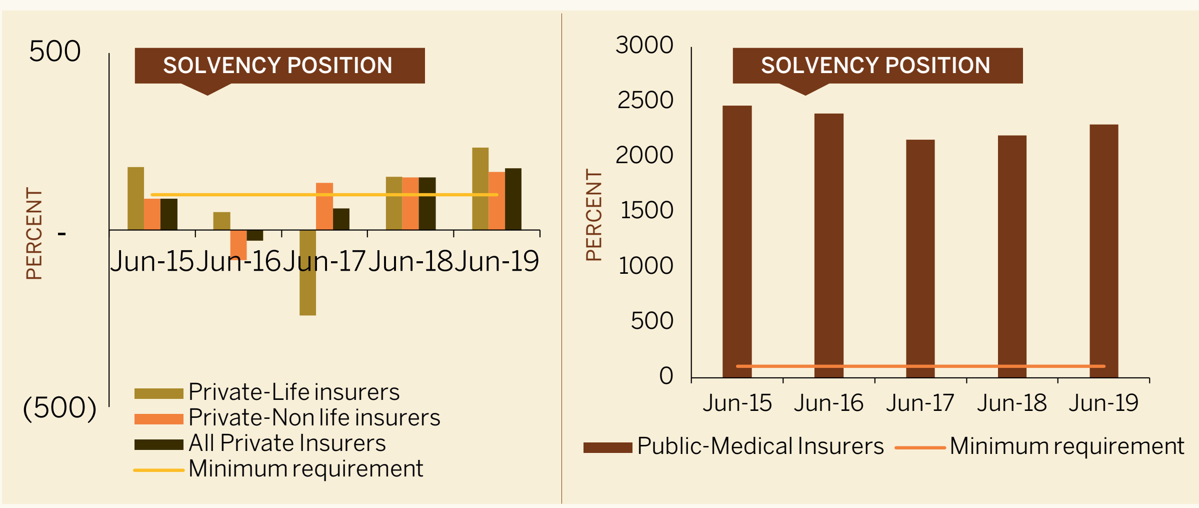
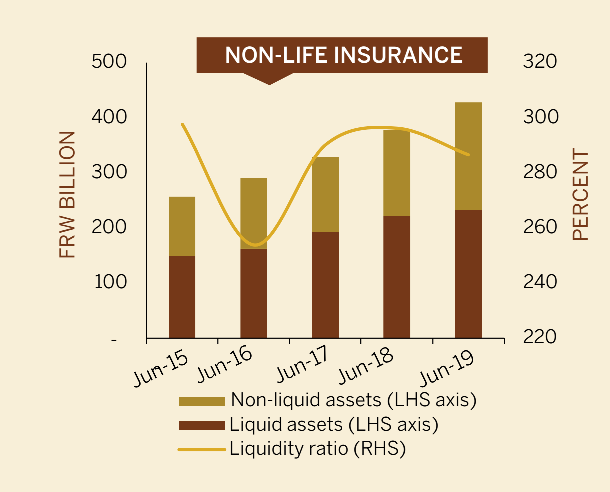
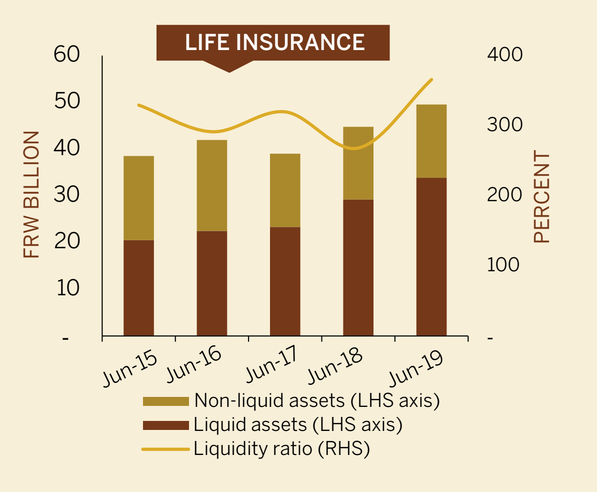


Figure 13: Liquidity positions




Source: **NBR, Financial Stability Directorate**

# PENSION SECTOR

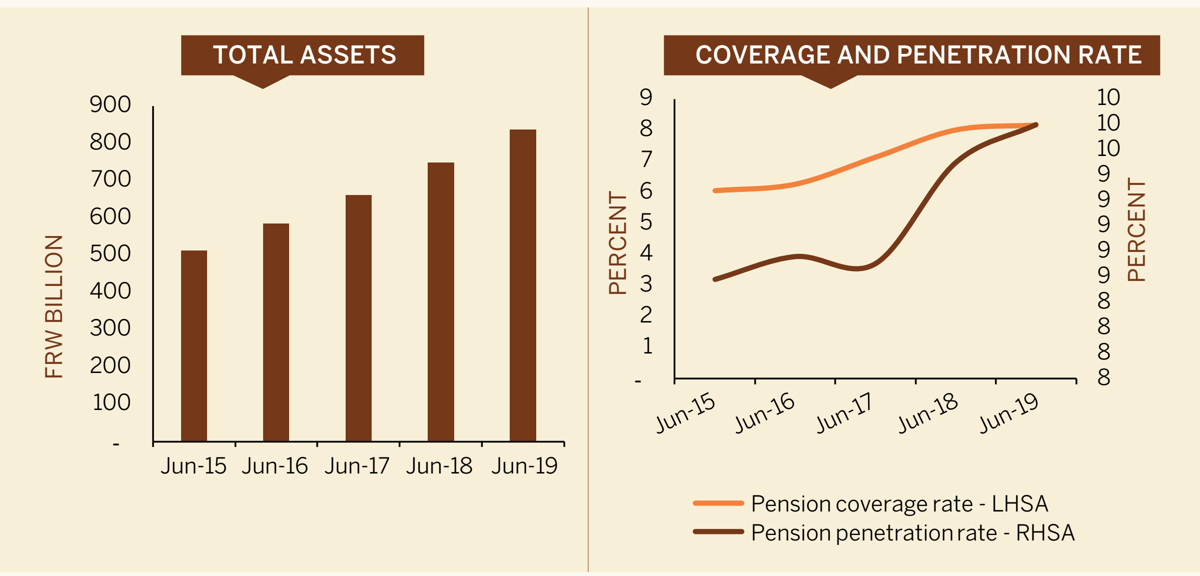
The pension sector is dominated by public pension Fund — the Rwanda Social Security Board (RSSB), accounting for 95 percent of pension sector's assets, while licensed private pension schemes account for 5 percent as at June 2019. These Pension Funds remain the largest contributors to the financial sector deepening, after banking sector. They promote the accumulation of savings from its members for long-term investments mostly in the financial sector, and stimulate the capital markets development.

As at June 2019, the pension Funds (both public and private) represented 17.8 percent of total financial sector assets and remain a key long term sources funds to financial sector, mainly banking sector. In the same period, 18.3 percent of the pension funds' assets were deposits in local banks and, 11 percent equities in local banks. Further, Pension funds also plays critical role in the capital market development with its growing investments mostly in domestic listed banks. As at June 2019, Public Pension Fund (RSSB) holds equity investments traded on Rwanda stock exchange (RSE) equivalent to FRW 92 billion compared to FRW 74 billion, the average of the last five years.

**Pension sector coverage remains low, at 8.2 percent in June 2019, reflecting the large number of people not saving for retirement, mainly in informal sector.** The low level of pension sector coverage is linked to low proportion of the population employed in the formal sector. The results of the labour force survey report by NISR, of December 2018, indicate that 77.6 percent of employed population are in the informal sector, 15.6 percent are in formal sector and 6.8 percent are in households as employes of domestic personnel.

Consequently, the penetration rate of pension sector (the size of assets over GDP), that gives the indication wealth accumulated by the sector, remained low and at 9.8 percent in June 2019, slightly higher than 9.5 percent in June 2018. The initiatives like launching Ejo Heza— National Long Term Savings Scheme (LTSS) and licensing private pension schemes are expected to tap into informal sector and deepen the pension sector coverage. An inclusive pension sector of member contributors with different standard of living, will not only ensure their stable income for retirement, but also increased long-term funds to the financial sector.

Figure 14: Assets Growth, Coverage and Penetration Rate




Source: **NBR, Financial Stability Directorate**

[6] NISR: National Institute of Statistics of Rwanda

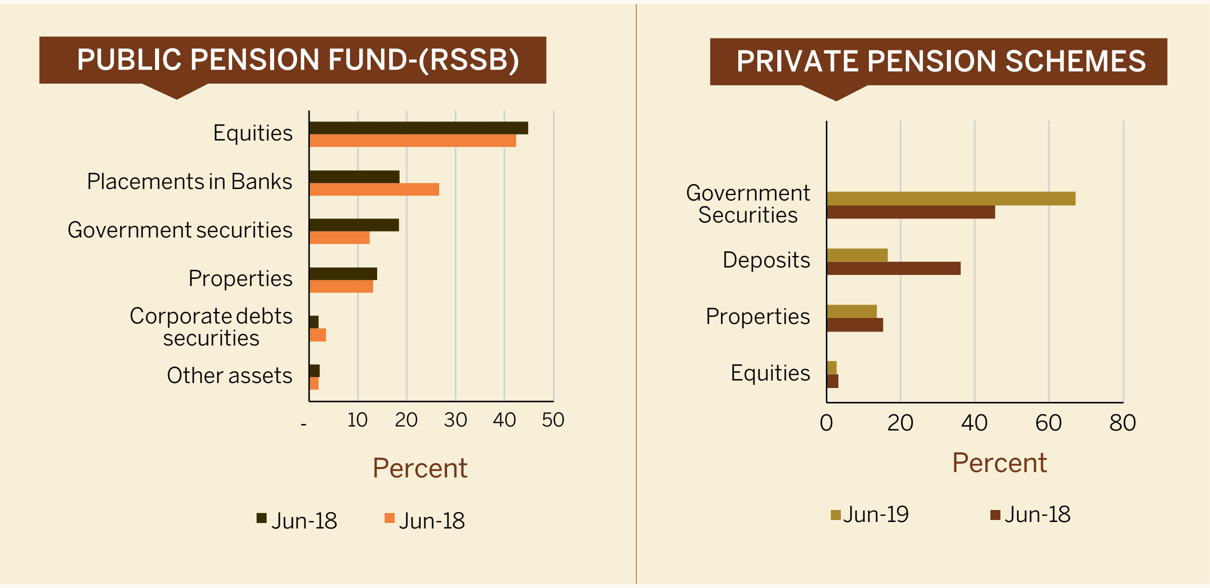
**With regard to the investment mix, Public pension fund (RSSB) holds a larger proportion of its investments in equity.** Equities investments represent approximately a half of the investment portfolio of Pension Fund. The Fund increased its holdings in equities from 42 percent in June 2018 to 45 percent of total assets in June 2019, of which the large portion are invested locally at a level of 76 percent and 24 percent in offshore. It is worth noting that most of these equities invested locally, are found in non-quoted corporations (68 percent of total investments in equities). The share of investments in government securities increased to 18 percent in June 2019 from 12 percent in June 2018, at expense of placements in banks (from 27 percent to 19 percent).

This increase is explained by higher yields in Government securities compared to yields of placements in Banks. In the same period, the share of investment in properties remained relatively stable in line with the perceived risks in real estate sector. The share of investment in properties increased from 13 percent to 14 percent of Pension Fund's total assets.

**Private pension schemes continued to invest much in fixed income securities with large share in government securities, followed by placements in Banks**. Given their small size compared to Public Pension Fund, these pension schemes are still only investing much in relatively lower risky investments (government securities and placements) compared to other risky investments. As they expand their balance sheet gradually, these pension schemes are expected to diversify its investment portfolio in other avenues. As at June 2019, private pension schemes increased significantly their share in government securities from 45 percent in June 2018 to 67 percent of total assets in June 2019.

On the other hand, they reduced its share of its holding in banks' placements (from 36 percent to 16 percent). Similar to the other financial institutions, private pension schemes also increased its share in government securities in search for higher yields compared to reduced interest rate on placements in Banks observed during the period under review.

Figure 15: Pension Funds Investment Allocation (% share)




Source: **NBR, Financial Stability Directorate**

# THE PAYMENT SYSTEMS PERFORMANCE

The efficiency of payment and settlement systems is vital to the smooth and efficient functioning of the financial system and the maintenance of public confidence in the system.

**Over the period under review, the payment system operated reliably.** The Rwanda Integrated Payment and Processing System (RIPPS), operated by the NBR, successfully settled all interbank transactions with no major disruptions- the system availability was at 99.7 percent, higher than the NBR target of at least 99 percent. During the FY 2019/18, RIPPs, settled 4,240,663 (worth FRW 10.519 billion) transactions, 13 percent higher than what it settled in the previous financial year.

After 8 years of operation, the NBR plans to upgrade RIPPS, largely to comply with international standards (ISO 20022 swift standard), to enhance the security of the RIPPS system; fetch new functionalities and improve the existing ones. The upgrade will also enable RIPPS system to work 24/7, which will enable banks to transact 24 hours a day and 7/7 days. As part of the RIPPS upgrade, the Central Security Depository (CSD)- a RIPPS component that accommodates all securities issued in Rwanda- will also be upgraded and integrated with other depositories of the EAC countries and Stock exchanges of the region to facilitate the securities exchange and trade among member countries of the East African Community.
The upgrade is expected to be launched in November 2019 and completed in the first half of 2020.

Table 8: RIPPS Performance

| PAYMENT TYPE | VOLUME | | | VALUE (FRW, BILLION) | | |
|---|---|---|---|---|---|---|
| | JULY 17- JUNE 18 | JULY 18- JUNE 19 | % CHANGE | JULY 17- JUNE 18 | JULY 18- JUNE 19 | % CHANGE |
| **Single Transfers** | 343,698 | 561,039 | 63.2 | 3,523.5 | 4,716.5 | 33.8 |
| **Multiple Transfers** | 2,307,580 | 3,405,444 | 47.6 | 1,354.9 | 1,932.5 | 42.6 |
| **Interbank Transfers** | 14,616 | 14,998 | 2.6 | 2,497.8 | 3,012.4 | 20.6 |
| **Cheques** | 223,176 | 259,182 | 16.1 | 655.2 | 857.9 | 31 |
| **Total** | 2,889,070 | 4,240,663 | 46.8 | 8,031.1 | 10,519.3 | 31 |

Source: **NBR, Financial Stability Directorate**

# REGULATORY DEVELOPMENTS AND INITIATIVES

The NBR continued to make progress on a wide range of regulatory policies deemed important for a sound and stable financial system. In this respect, the Bank reviewed and enhanced the already existing legal instruments, but also established new ones. In establishing these legal instruments, the NBR was guided by international standards as well as market developments. Below are key legal instruments gazetted since July 2018, as well as other initiatives.

## Law Governing Credit Reporting System

The existing law on credit reporting system, which was enacted in 2008, was reviewed. The new law N° 73/2018 of 31/08/2018 was published in the official gazette n° 37 of 10/09/2018. The main reasons for this review was to extended the mandatory data providers to include telecommunication companies and public services utilities, in addition to Banks, insurance and microfinance. Further, the law set requirements to strengthen the data submission mechanism in the credit bureau (complete, accurate and timely credit information), require an operator of credit bureau to provider service that is secured, reliable, efficient, and having an IT solution capable of delivering credit reports.

The law also establish a Credit Reporting Council as a forum of different stakeholders where issues related to credit reporting system will be discussed.

## Law on Prevention and Punishment of Money Laundering and Terrorism Financing (AML/CFT Law)

This new law N° 69/2018 of 31/08/2018 published in the official gazette n° 37 of 10/09/2018 repealed the AML/CFT law that was enacted in 2008. The reasons of this review was to ensure that the current AML/CFT comply with the international standards, the Financial Task Force Recommendations (FATF 40 recommendations). The law also has addressed most of the gaps that were identified during the Mutual Evaluation report (MER) that was undertaken by the IMF and endorsed by Eastern and Southern Anti Money Laundering Group (ESAAMLG). Among gaps that were addressed by the new law are the review of the money laundering and financing of terrorism definitions, considering insurance companies, trusts, casinos as reporting persons, requiring supervisory authorities to monitor the compliance of the law by reporting persons as well as issue administrative sanctions for non-compliance.

## Regulation Governing Non-Deposit Taking Financial Institutions (NDFIS)

In December 2018, the NBR extended its regulatory perimeters to non-deposit taking credit institutions. The Bank issued a Regulation to govern non-deposit taking financial institutions (Regulation N° 2100 /2018 – 00011 [614] of 12/12/2018). This regulation establishes regulatory standards for non-Bank financial institutions that principally perform financial services in the form of non-deposit taking lending financial services or related financial services. These institutions include: credit services only, mortgage finance services, credit guarantees, refinancing services, factoring services, debt collection services and other financial services that the Central Bank may qualify as posing systemic risk to the financial sector stability. In establishing this regulation, the NBR aimed at containing systemic risks to the financial sector that might emanate from this unregulated section of the financial system, as well as protecting consumers of financial services in this segment of the market. By regulating non-deposit taking financial institution, the NBR joined several global financial regulators.

Experience from around the globe indicate that growth of unregulated financial service providers and their interdependence with traditional financial system pose great risk to the financial system. In containing these risks, financial regulatory bodies around the world are therefore extending their regulatory perimeters to these institutions. This regulation specifies licensing requirements for non-deposit taking financial institutions, minimum capital requirement, permissible funding sources, transparency requirements, accounting and financial reporting standards, governance standard and, reporting requirements to the NBR.

## DSIBs Framework

In line with global trends, and as part of reforms to foster financial stability, the NBR developed and issued a framework for regulation and supervision of Domestically Systemically Important Banks (D-SIBs). The framework specifies the assessment methodology for identifying D-SIBs and additional regulatory requirements for identified D-SIBs.
A systemically important Bank is defined as a Bank whose failure might largely disrupt the functioning of the entire financial system, with far reaching impact on the economy.

By implementing this policy tool, the NBR aimed at creating stronger risk management practices that would reduce the systemic risk that SIBs pose to the financial system. The methodology adopted in defining D-SIBs follows the Basel guidance, but with adjustments to meet the local context. The methodology ranks banks based on 5 broad indicators: the size, interconnectedness, substitutability, complexity and cross-jurisdictional activities. In implementing this framework, every year, the NBR will identify and communicate D-SIBs to the Banking industry (in June every year). The assessment shall be based on annually audited financial statements of Banks, usually available in April. Identified D-SIBs shall comply with specific requirements provided in the framework. Identified SIBs will be required to provide, among other things, specific recovery plans and shall be subjected to more on-site supervision.

## Regulation on Licensing Conditions for Banks and Insurers

The NBR revised the licensing requirements of Banks and insurance companies. For Banks, the NBR revised the licensing requirements by re-defining categorization of Banks and increasing the minimum capital requirement for different categories of Banks. Through the revised licensing regulation for Banks (Regulation N° 2310/2018 – 00013 of 27/12/2018), the NBR established four categories- commercial Banks, development Banks, cooperative Banks and mortgage Banks.

As per this Regulation, microfinance Banks will shift from the Banking regulatory framework to the Microfinance to ensure proportionality in regulation and supervision. Another element revised in the licensing requirements of Banks is minimum capital. The minimum paid up capital requirement of commercial Banks was increased from FRW 5 billion to FRW 20 billion. For development Banks, the minimum capital requirement was increased from FRW 3 billion to FRW 50 billion. The paid up capital for the new categories of Banks (Cooperative and Mortgage Banks) was set at FRW 10 Billion. Banks have a 5-year transition period to build up the capital to the new required levels. The overall basis for increasing capital requirement of Banks was to strengthen the resiliency of the Banking sector and increase their capacity to expand their businesses. The initial minimum capital requirements were established 10 years back (2008). Since then, much has changed, the economy has developed, the financial sector has developed and risks have increased. Going forward, new Banks that apply for license will be required to meet the established capital requirements.

In the same spirit, through Regulation N° 2310/2018 - 00014[614] of 27/12/2018), the NBR revised the licensing requirements of insurance companies. For reasons similar to Banks, the NBR increased the minimum paid up capital for general insurance from FRW 1 billion to FRW 3 billion, and for life insurance from FRW 1 billion to FRW 2 billion. Further to this, NBR also introduced two additional categories of insurance companiesÐHealth Maintenance Organizations (HMOs) with a minimum paid capital requirement of FRW 500 million, and reinsurers with minimum paid up capital requirement of FRW 5 billion. Insurance companies were also given a transitional period of 5 years to comply with this new capital requirements. Going forward, new insurance companies that apply for license will be required to meet the established capital requirements.

## Regulation Governing the Micro-Insurance Organization

In December 2018, the NBR issued a new regulation governing the micro insurance business (Regulation No 2100 /2018 – 00012[614] OF 12/12/2018). The purpose of this Regulation is to create conducive environment for micro-insurance business, regulate micro-insurers, protect micro insurance policyholders, promote and develop micro-insurance business in Rwanda.

This regulation stipulates requirements for micro-insurance institutions and traditional Insurers that also offer micro-insurance products. According to this regulation, micro insurance refers to any financial arrangement aimed to protect low income people against specific perils through specific products in exchange of regular payment of premium proportionate to the likelihood and cost of the risk involved. This regulation stipulates among other things, licensing requirements, governance requirements, prudential requirements and reporting requirements.

## The Directive on RBC Requirements

The NBR is moving to a Risk Based Capital (RBC) regime. Since the enactment of the insurance law in 2008, the NBR has been using the compliance based solvency approach. In order to align with the international supervisory practices, the NBR is moving to a more sound and robust prudential supervision framework for insurance, RBC approach. It is based on the risk profile of each individual insurance company in order to promote comparability, transparency and competitiveness. The parallel run for the RBC implementation started in October 2018. This period will help Insurers to gauge their compliance level vis-à-vis the new prescribed capital adequacy requirements and allow shareholders to address any gaps identified during the prescribed transition period. It is also a period for the Insurers to build capacity and skills in their technical teams (underwriting, claims, and finance) for the full implementation of the new solvency regime.

## Directive on Loan to Value Ratio

Effective April 2019, the NBR established a Directive on Loan-To-Value (LTV) limits (Directive No 2600/2019-00015 (613). This directive caps the size of mortgage loans relative to the value of the property associated with the loan. As per this directive, the LTV limits for construction or purchase of commercial property was established at 80 percent- meaning that The Bank can contribute up to 80 percent of the value of the property and the borrower contributes 20 percent. The LTV limit for residential properties was established at 100 percent for the first house and 80percent for subsequent houses. The NBR shall regularly review these limits basing on developments in the housing market and credit market.

By introducing the LTV limits, the NBR aims to prevent systemic financial sector risks associated with boom and burst cycles in the property markets. Setting LTV limits helps in three aspects: First, it strengthens the borrowers' resilience against future house price shocks. Second, the limits promote responsible borrowing by requiring the borrower to make a certain contribution to the project. Third, it limits the level of exposures Banks take on when underwriting a mortgage.

This directive requires Banks to disburse loans for the construction or purchase of the property after the borrower has contributed his/her portion. Certain instruments like Government bonds, deposit certificate, personal and complimentary pension savings are acceptable guarantees of the borrowers contribution. The contribution of the borrower should not be borrowed from other financial institutions. The NBR shall monitor implementation of this directive through regular on-site and off-site inspections.

## Regulation Governing the Shareholding, Acquisition and Amalgamation of Banks

The NBR established a regulation governing the shareholding, acquisition and amalgamation of Banks (Regulation N° 2310 /2019 –00023 [614] of 19/3/2019). This regulation aims to ensure that any new acquisition or ownership does not expose Banks to undue risks or hinder effective supervision. This regulation reflects another milestone achieved by NBR in complying with the international principles of effective bank supervision (also known as Basel Core Principles) - particularly principle 6 and 7 of BCPs. This regulation contains four essential elements:

1. Prescribes criteria, including fit and proper tests, for approving requests for proposed mergers and acquisitions of regulatednfinancial institutions;
2. Sets minimum conditions that must be fulfilled by merging or acquiring regulated financial institutions during the due diligence process;
3. Provides guidance on the processes and procedures for evaluating applications for merger and acquisition and the required documents or agreements to be submitted and;
4. Prescribes post-merger or post-acquisition / amalgamation requirements.

To implement this regulation, Banks are obliged to submit to NBR names and holdings of all significant shareholders or those that exert controlling influence, including the identities of beneficial owners of shares.

## Regulation on Major Investment and Placements of Banks

The NBR established a regulation on major investments and placements of Banks (Regulation N° 2310 /2019 – 00022 [614] of 19/3/2019).
This regulation replaced two regulations of 2011 on major investment and baking placements of Banks. This regulation aims to minimize risks related to excessive investment in immovable properties and equities, the two assets whose value gets greatly affected by changes in market sentiments. This regulation sets restrictions on: (1) acquisition of immovable properties, (2) investment in shares of other companies, (3) placements and deposits in other financial institutions.

The regulation above allows Banks to acquire immovable properties only for the purpose of conducting their business (offices) or providing amenities for their employees. In other words, Banks are not allowed to do direct investment in properties like commercial real estate. Where a bank acquires immovable property for acceptable reasons like conducting their business or providing amenities for its staff, this investment should not exceed 50 percent of the Bank's core capital. This investment limit does not however apply to immovable collaterals acquired by Banks in recovery of debt owed to a bank if this property is disposed of within a 1-year period from the acquisition date.

Banks' maximum aggregate investment in equity shares of other companies was established at 25 percent of core capital. Banks are also obliged to seek approval from the NBR before making major investment in equity shares of other companies.

The regulation established the maximum placements that Banks can make in foreign financial institutions as follow: Banks can place or deposit up to 50 percent of their core capital in foreign financial institutions with long term international rating by a recognized international rating agency of "A" or above and 30 percent with long term international rating by a recognized international rating agency of "B" or above. In addition to investment thresholds, Banks are required to establish adequate prudential policies and procedures that minimize risks related to concentrated placements.

## Insurance Sector Anti-fraud and Related Financial Crimes Forum

In June 2019, the NBR facilitated the establishment of the insurance sector anti-fraud and related crimes forum. This forum, composed of representatives from 27 public and private institutions, aims to help co-ordinate action against insurance fraud and other financial crimes.
Fraud in the insurance sector largely takes two-forms- (1) fictitious and intentionally inflated insurance claim and, (2) manipulation of facts at the time of insurance application in order to lower their premium. In either form, fraud negatively affects the insurance sector through increased losses and consumers of insurance products through increased premiums. The other financial crimes that the forum will handle include money laundering and financing terrorism cases, as well as cybercrimes. The NBR underscores that the newly established fraud forum will supplement its existing prudential oversight to minimize fraud and financial crimes in the insurance sector. The composition of the fraud forum includes law enforcement agencies that will help to investigate and prosecute identified cases.

The first meeting of the insurance anti-fraud forum was held on June 13, 2019 and approved the following terms of reference (TORs).

i. sharing of information between and within the financial sector on fraud incidents;

ii. Promote public awareness about fraud and financial crimes and their prevention;

iii. Build and exploit improved information and knowledge, providing a center of expertise to raise the priority of fraud and financial crimes, secure and target counter fraud resource appropriately and achieve better prevention and enforcement of fraud and financial crimes mitigation measures;

iv. Address the key fraud and financial crimes enablers and high threat areas by prioritizing and driving forward specific multi-partner interventions to reduce them;

v. Discuss/deliberate on the identified cases and devise strategies to curb them.

## Regulation on Minimum Internal Control and Audit for Banks

In August 2019, the NBR enhanced the regulation on internal control and audit for Banks (Regulation N° 4230 /2019 - 00024[614] OF 5/6/2019). This regulation replaced the one established in 2011 and aims to set the minimum internal control and internal audit standards that bank should put in place to contain potential risks in their operations. The NBR believes that an effective internal control is a critical component of bank management and a foundation for the safe and sound operation of banking institutions. The enhanced regulation provides the following five key internal control principles that Banks must observe while setting their internal control systems:

### i. Management oversight and the control culture:

The regulation emphasizes the role of the board of directors as the ultimate body responsible for ensuring that an adequate and effective system of internal controls is established and maintained in Banks. The regulation requires Banks to have board members that are objective, capable, and inquisitive, with a knowledge or expertise of the activities of and risks run by The Bank.

### ii. Risk recognition and assessment:

The regulation requires Banks to establish internal control system that enable them to identify and evaluate all types of material risks that could adversely affect the achievement of The Bank's goals. The senior management of The Bank is required to continually evaluate these risks and establish proper controls.

### iii. Control activities and segregation of duties:

The regulation requires that an appropriate control structure is setup in Banks, with control activities defined at every business level. These should include top-level reviews; appropriate activity controls for different departments or divisions; physical controls; checking for compliance with exposure limits and follow-up on non-compliance; a system of approvals and authorizations; and, a system of verification and reconciliation.

### iv. Information and communication:

The regulation requires Banks to have adequate and comprehensive internal financial, operational and compliance data, as well as external market information about events and conditions that are relevant to decision making. Information should be reliable, timely, accessible, and provided in a consistent format.

### v. Monitoring activities and correcting deficiencies:

The regulation requires that Banks regularly monitor their internal control systems with the aim of improving them. This provision is because The Banking sector is very dynamic and rapidly evolving, hence, Banks must continually monitor and evaluate and improve their control systems.

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