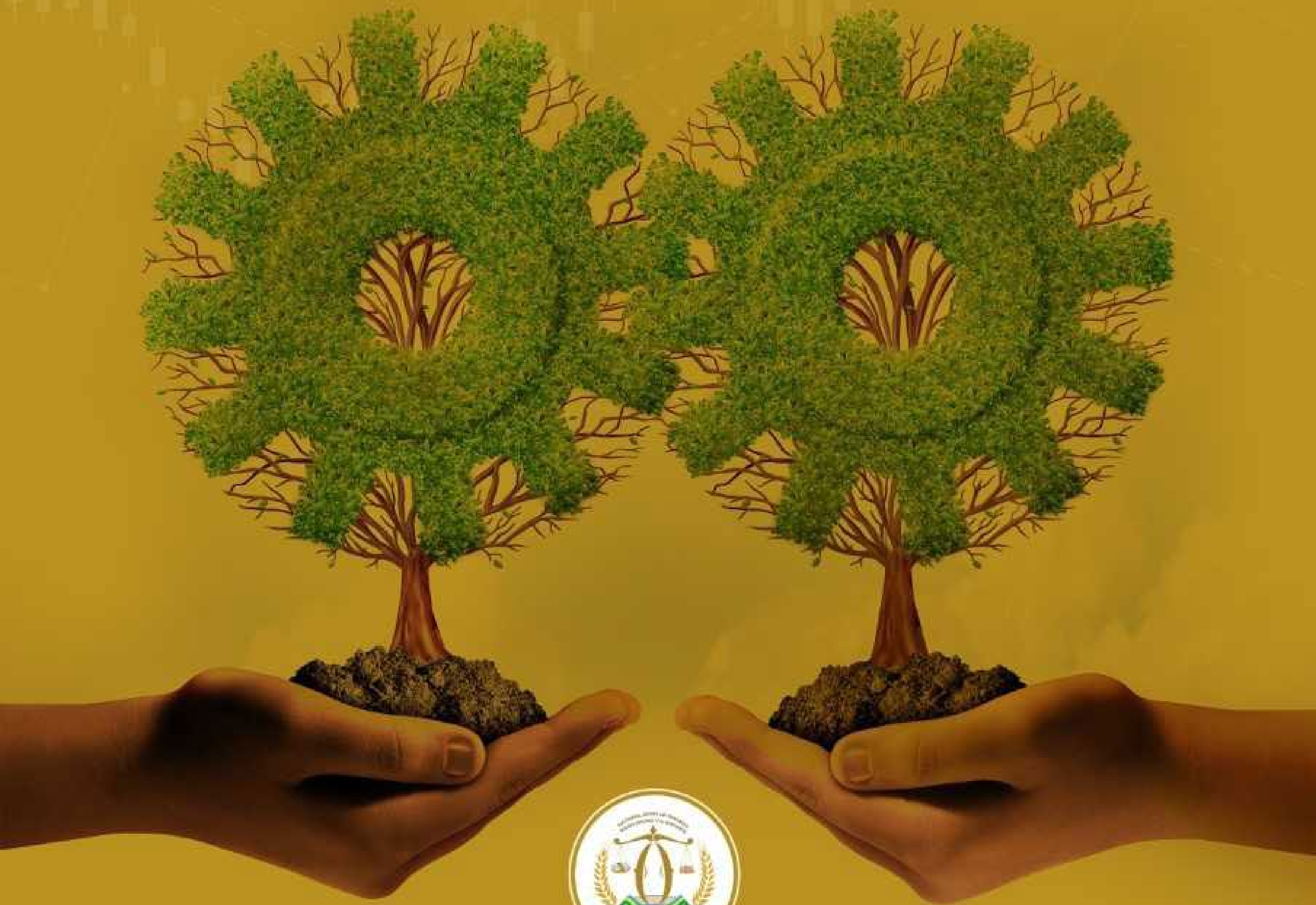

NATIONAL BANK OF RWANDA
BANKI NKURU Y'U RWANDA

ANNUAL FINANCIAL STABILITY REPORT

JULY 2019 - JUNE 2020

CONTENTS

NBR IDENTITY STATEMENT

The National Bank of Rwanda strives to be a World class Central Bank contributing to economic growth & development, by using robust monetary policy tools to maintain stable market prices. The Bank ensures financial stability in a free market economy as it embraces innovation, inclusiveness, and economic integration.

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

MUTUAL-RESPECT AND TEAM-WORK

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

ACCOUNTABILITY

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

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.

> Rwanda’s financial sector entered the crisis with sufficient capital and liquidity which enabled the sector to remain resilient in first half of 2020.

Foreword

Welcome to this edition of the National Bank of Rwanda's (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 annual FSR is the NBR flagship report that summarizes the 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.

This Annual FSR comes at a time when the global economy is grappling with the COVID-19 pandemic. The pandemic has not only taken lives, but deteriorated the global economic conditions and increased vulnerabilities to the global financial systems. In Rwanda, the necessary virus containment measures taken affected firms and household income, especially in sectors like Tourism, hotels and transport. This obviously increased credit and liquidity risks for the financial sector.

The Rwanda financial sector entered the crisis with sufficient capital and liquidity and this enabled it to remain resilient in first half of 2020. In fact this pandemic emphasized the importance of building buffers during the good times and using them during the bad times. The pandemic, however, increased credit risk in the financial sector, especially through weakening the balance sheet of corporates and households. The outlook of the financial sector is expected to be shaped by the speed of economic recovery in forthcoming years and effective risk management among financial institutions.

Going forward, the NBR will ensure proper monitoring of credit and liquidity risks among supervised institutions and enforce appropriate classification and adequate provisioning. The NBR believes that accurate and timely data is important in crisis period like the current one for appropriate intervention.

RWANGOMBWA John
Govenor

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Global Economic and Financial Conditions

The global economy is headed for the deepest global recession since the World War II due to the prevailing COVID-19 pandemic (Table 1). The virus continues to spread, with the number of cases surpassing 39 million and more than one million deaths globally as at 21st October 2020. New cases are accumulating at a rate of more than 300,000 per day, with particular concentrations in Latin America, India, South Africa, and the Russian Federation among emerging markets and developing economies (EMDEs) and the United States among advanced economies. The synchronized stringent lockdown measures implemented by Governments worldwide to contain the spread of the virus, including closing business, schools, and stopping people from leaving their homes, except for essential services, weighed down economic activities in all countries. In effect the Global economy is projected to shrink by 4.4 Percent (IMF-WEO October 2020) — the deepest recession since World War II. All global sub-regions are projected to register negative growth, the deepest being advanced economies (-5.8 percent); emerging and developing economies (-3.3 percent); and Su-Saharan Africa (-3.0 percent). The service sector that requires face to face interactions was the hardest hit sector across the globe, followed by manufacturing.

Although the extraordinary and unprecedented fiscal, monetary, and regulatory policy measures taken by policy makers globally have prevented the worst outcome from the pandemic so far, the speed of global economic recovery is not assured while the pandemic continues to spread. At the onset of the pandemic, Governments in both advanced, emerging and developing countries responded with a variety of fiscal and monetary countermeasures that included efforts to cushion income losses, incentivize hiring, expand social assistance, guarantee credit, and inject equity into firms, offering liquidity to the financial sector, and allowing for flexibility in prudential rules. These measures, combined with the lifting of lockdown measures in May 2020 in several countries prevented widespread firm bankruptcies; provided social protection to vulnerable households and supported stability of global financial sector. However, prospects for speedy global economic recovery remain highly uncertain, especially given that the pandemic continues to spread. There is evidence of new COVID-19 infection upticks in places that had reduced local transmission to low levels and this has stalled the re-opening of economies and in some cases triggers targeted shutdowns to control the second wave of infections. In addition to this, the monetary and fiscal space of emerging and developing countries to confront the second wave of the pandemic is limited. This therefore implies that prospects of global economic recovery is highly uncertain and will highly depend on the trajectory of the pandemic, availability of reliable and adequate COVID-19 treatment and vaccines doses.

Table 1: The Global Growth and Projections.

Growth Projections by Region	2017	2018	2019	2020 Proj.	2021 Proj.
World	3.8	3.5	2.8	-4.4	5.2
Advanced Economies	2.4	2.2	1.7	-5.8	3.9
United States	2.3	3.0	2.2	-4.3	3.1
Euro Area	2.6	1.8	1.3	-8.3	5.2
Japan	2.2	0.3	0.7	-5.3	2.3
United Kingdom	1.9	1.3	1.5	-9.8	5.9
Emerging Markets & Developing Economies	4.8	4.5	3.7	-3.3	6.0
Russia	1.8	2.5	1.3	-4.1	2.8
Brazil	1.3	1.3	1.1	-5.8	2.8
China	6.9	6.7	6.1	1.9	8.2
India	7.0	6.1	4.2	-10.3	8.8
Sub-Saharan Africa	3.1	3.3	3.2	-3.0	3.1
Nigeria	0.8	1.9	2.2	-4.3	1.7
South Africa	1.4	0.8	0.2	-8.0	3.0
Angola	-0.2	-1.2	-0.9	-4.0	3.2
East African Community	5.7	6.5	6.2	1.0	4.5
Uganda	7.3	6.1	6.7	-0.3	4.9
Kenya	4.8	6.3	5.4	1.0	4.7
Tanzania	6.8	7.0	7.0	1.9	3.6
Rwanda	4.0	8.6	9.4	2.0	6.3
Burundi	0.5	1.6	1.8	-3.2	3.1
South Sudan	-5.8	-1.9	0.9	4.1	-2.3

Source: IMF, WEO, October 2020.

Global Growth

The Global economy is projected to shrink by

-4.4%

in 2020

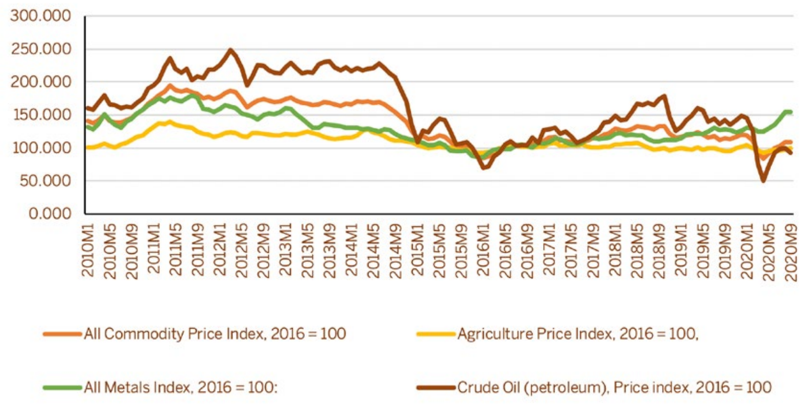
FROM 2.8%

in 2019

IMF-WEO October 2020.

Commodity prices are recovering since June 2020 and this is expected to support the economic recovery efforts for commodity exporting countries (Figure 1). Commodity prices plummeted during the early months of the COVID-19 pandemic largely due to lower demand and as countries implemented lockdowns to contain the spread of the virus. The IMF's primary commodity price index, that tracks developments in commodity prices fell by24 percent between February and April 2020 as the COVID-19 pandemic intensified. This drop in commodity prices and weak external global demand increased external imbalances for commodity exporting countries, especially Sub-Saharan African (SSA). The World Bank projects SSA median current account deficit to widen from -4.8 percent of GDP in 2019 to -6.9 percent of GDP in 2020, the highest since the 2014 commodity price shock (World Bank, African Pulse, October 2020). However, as countries started lifting lockdowns, and economic activities resumed in China, prices of commodity prices are showing signs of recovery. The same IMF primary commodity index increased by 31 percent between April and August 2020. Except oil, whose prices could be influenced by the OPEC supply cuts, the other primary commodity prices (metal; Agriculture and other non-Agricultural products) will continue to be influenced by global demand, or the resumption of economic activities in anchor countries like China. In the context of SSA and Rwanda in particular, the improved commodity prices reduce exchange rate pressures and offer space for monetary policy interventions to support economic recovery.

Figure 1: Global Commodity Price Index (2016=100)



Source: IMF Primary Commodity Price database

Global financial conditions have remained accommodative since June 2020, after tightening during the early months of the pandemic. Financial conditions tightened during the first quarter of 2020 reflecting the deterioration of investor sentiments caused by the outbreak of the pandemic— this caused sharp drops in equity prices in both advanced and emerging economies, and capital reversals to safe haven, increase of interest rate spread on risk assets. Since June 2020, however, the unprecedented monetary and fiscal policy actions taken by Governments globally were successful to boost investor confidence and have quickly eased global financial conditions— equity prices have picked up; interest rates remain low and the appetite for risk assets has increased. The prevailing disconnect between global economic fundamentals and risk pricing or financial markets in general is a key risk to the global financial system as potential asset price corrections may cause financial instability.

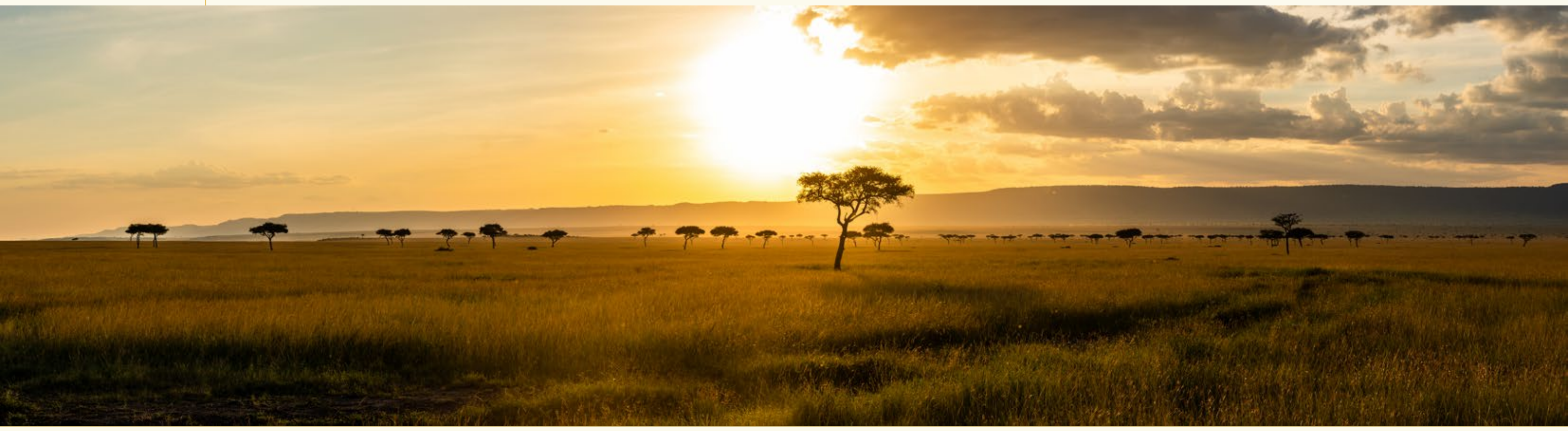
Globally, banks entered the COVID-19 crisis with ample capital and liquidity which helped them to absorb the first round of losses, but a deeper recession could compromise their stability, requiring further interventions. In the wake of the 2007-2008 financial crisis, policymakers improved the suite of safeguards that mitigate the chances of instability in the banking system. These efforts have contributed to the banking system's initial resilience to this crisis. The main vulnerabilities to banks globally relate to rising credit risk from the non-financial corporate sector. Firms have taken on more debts to cope with cash shortages, the losses making corporate sector and household loss of income could all increase credit risks. If the crisis persists, liquidity problems facing firms globally could turn into insolvency issues. The regulatory forbearance offered by regulators globally was a short-term measure taken with a common assumption that the economic challenges would be fixed in the near-term. However, the economic projections by the IMF demonstrate that economic recovery, globally, will be gradual, uneven and much depend on the availability of the COVID-19 treatment or vaccine.

2 Macrofinancial Developments in EAC

Economic and financial developments in the EAC region are of particular importance to Rwanda's economy and financial system for 3 reasons: First, Rwanda trades with the EAC member states, meaning that shocks in the block affects Rwanda. Its formal exports to the EAC block accounted for 16.8 percent of its total formal exports in 2019, while informal cross-border exports with EAC partner states reached USD 109 million in 2019. Second, the existing financial interlinkages of the EAC financial systems offer channels of contagion. For example, Rwanda hosts subsidiaries of 5 Kenyan Banks with a market share of 26.3 percent of total banking sector assets. Lastly, the convergence road map and plan for a future monetary union, and fully integrated financial system calls for sustained financial stability in the region. Paragraphs below summarize economic and financial sector conditions in the EAC during the COVID-19 pandemic.

Developments in the EAC region were largely shaped by COVID-19 outbreak and measures taken by Governments to contain the spread of the virus. As of October 21, the numbers of COVID-19 confirmed cases reported by the World Health Organization (WHO) were 46,144 in Kenya; Uganda (10,933); South Sudan (2,872); Rwanda (5,012); Tanzania (509) and Burundi (551). Although the spread and fatality rates are low in this region compared to cases in Europe, Asia and America, the containment measures taken by EAC member states, especially Kenya; Rwanda and Uganda weighed down economic growth. In Q2, 2020, due to the pandemic, economies of Kenya and Rwanda contracted by 5.7 percent and 12.4 percent respectively. In Uganda, the growth of real GDP moderated to 3.1 percent in Q2 2020 from 6.8 percent in Q2 2019, while in Tanzania, the growth of real GDP moderated to 5.7 percent in Q2 2020 from 7.2 percent in Q2 2019. The Q2 2020 national accounts data for the other EAC partner states (Burundi and South Sudan) was not available at the time of writing this report.

The policy interventions implemented by EAC Governments, coupled with the firming up of external demand are expected to buoy-up the regional economies in the second half of 2020 and 2021. The key policy measures implemented by EAC countries include : i) putting in place Government guarantee schemes to back commercial credit, ii) cutting central bank policy rate, iii) reducing reserve requirements, iv) easing capital requirements, v) granting exceptional permission to lending institutions to restructure loans of borrowers that have been affected by the pandemic, vi) providing exceptional liquidity assistance to commercial banks and vii) establishing the Government support funds, among others. These measures, along with the gradual lifting of lockdowns, improving global demand and, improving commodity prices, are expected to drive the economic recovery in the EAC region. In fact high frequency and leading indicators (e.g., composite index of economic activities) point to improved economic growth in Q3 2020 across the EAC member states. Nevertheless, there are downside risks to growth in the region, including prospects of a second wave of locusts, which would harm agricultural production, the possible rise of COVID-19 infections and fatality rates that could cause countries to reinstate lockdown measures; the shaky global demand that could swing either way depending on the trajectory of the spread of the virus. The bottom line is that the sustained recovery of EAC economies is not assured.



The EAC financial system showed resiliency to COVID-19 crisis although vulnerabilities of credit risk remain elevated. The banking system in all EAC partner states maintained capital and liquidity levels above the prudential requirement (Table 2). These buffers enabled financial institutions in the region to withstand the crisis and to continue lending to viable firms in the first 9 months of 2020. Across the region, the Non-Performing Loans (NPLs) ratio, an indicator of asset quality, never increased to the tune of deteriorating economic fundamentals as Banks in the region offered payment relief to their good customers affected by the pandemic. For example, as at end June 2020, Banks in Kenya restructured 29 percent of total loan portfolio; Tanzania (0.6 percent); Uganda (31.2 percent) and Rwanda (39 percent). In the next one year or so, financial stability in the EAC region will largely depend on performance of these restructured loans, which is also dependent of speed of economic recovery. The timely recognition of losses and appropriate and timely intervention of regulators in the region will be key to withhold financial stability in the EAC region. Regional supervisory college arrangements for cross-border banks will be critical to control potential contagion risks among partner states.

Bank lending slowed down in some EAC countries, reflecting weak demand for credit and tighter lending standards implemented by banks to control credit risk. The outstanding banking sector credit in Kenya grew by 7.6 percent (Y-o-Y) as at end June 2020, against 5.2 percent registered in June 2019. In Rwanda, banking sector credit moderated to 14.6 percent as at end June 2020 from 16.6 percent as at end June 2019, while in Uganda, the growth of credit to private remained stable around 13 percent. The moderation of lending in EAC partner states mainly reflects the weak credit demand and increased credit risks arising from the COVID-19 pandemic. In Tanzania and Burundi, growth of bank loans picked up— in Tanzania by 4.2 (from 0.7 percent in June 2019); and in Burundi by 22.4 percent, (from 11.3 percent in June 2019) reflecting the lesser stringent COVID-19 control measures implemented in these countries. The moderation of lending of banks in some EAC banks, and the deterioration of asset quality, indicate that profits of the financial sector in the region will be compressed in 2020 or even in 2021.

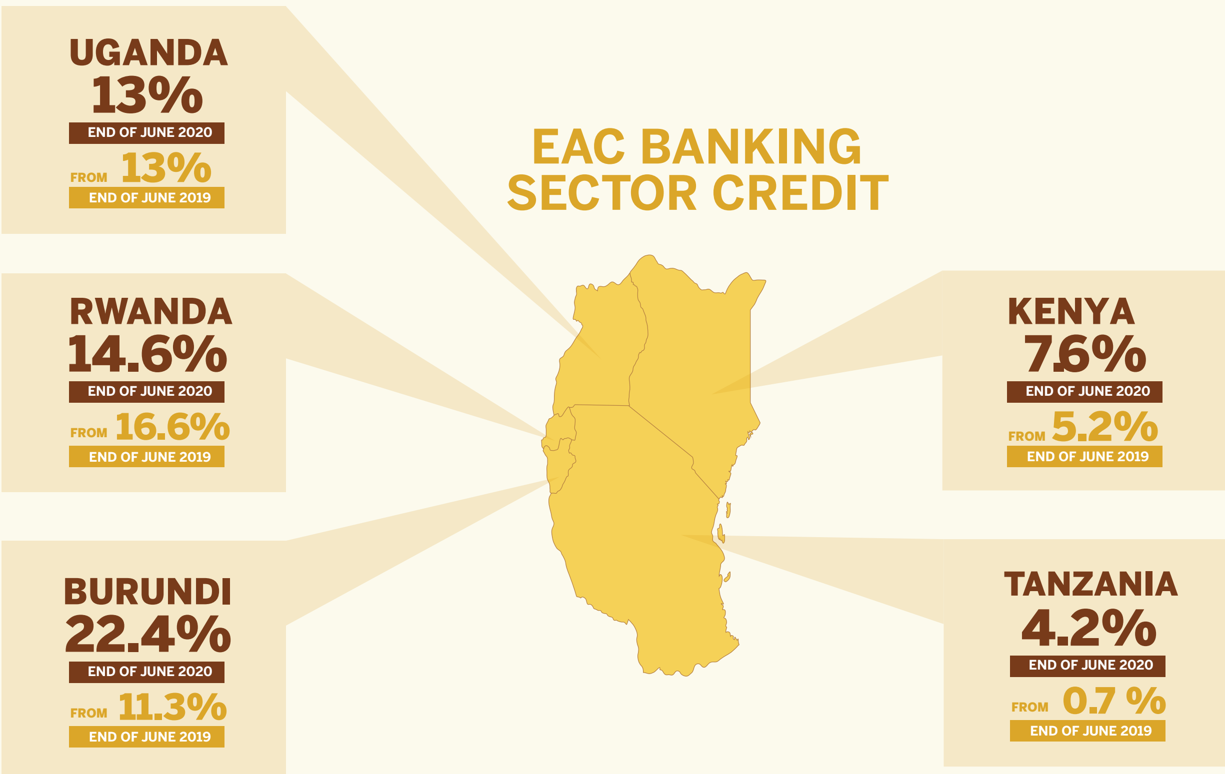


Table 2: The Selected Financial Soundness Indicators

CAR (%)	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
KENYA	18.4	18.2	18.3	19.6	18.7	18.5
TANZANIA	18.4	18.1	17.9	17.6	17.9	17.9
UGANDA	22.2	21.3	21.4	21.8	21.9	22.7
RWANDA	24.1	23.3	23.7	24.1	24.9	23.6
BURUNDI	25.1	24.0	27.5	21.6	29.7	24.6
Liquidity Ratio (%)	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-19
KENYA	49.8	50.61	50.9	49.6	51.2	55.6
TANZANIA	34.1	34.8	31.0	32.1	30.9	39.0
UGANDA	44.9	46.6	51.4	49.0	49.6	49.1
BURUNDI	21.5	21.2	18.2	18.1	17.2	15.5
NPLs Ratio (%)	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-19
KENYA	12.8	12.7	12.4	12.1	12.7	13.1
TANZANIA	10.9	10.7	11.0	10.1	11.0	10.8
UGANDA	3.8	3.8	4.4	4.9	5.4	6.0
RWANDA	6.3	5.6	5.3	4.9	5.5	5.5
BURUNDI	8.8	9.7	8.3	5.6	6.6	6.2
ROA (%)	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-19
KENYA	2.9	2.8	2.7	2.5	2.3	0.7
TANZANIA	1.1	1.9	1.8	1.8	1.9	2.2
UGANDA	3.9	3.7	3.9	3.9	3.8	3.5
RWANDA	3.1	2.6	3.1	3.3	3.2	2.7
BURUNDI	1.1	2.2	3.4	4.1	1.1	2.1
ROE (%)	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-19
KENYA	24.6	23.8	22.5	21.2	20.4	15.6
TANZANIA	7.7	8.8	7.8	6.6	8.5	9.8
UGANDA	15.9	15.8	16.0	16.7	15.8	15.2
RWANDA	12.8	9.3	11.7	12.5	11.8	9.9

Source: EAC Partner States Central Banks

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Implications of Prevailing Global and Regional Macro-Financial Conditions on the Rwandan Economy and Financial System

Performance of the global economy affects the demand for Rwanda's exports of commodities and services, remittances flows, foreign direct investment and; foreign aid. In context of current weak global demand and related slowdown of foreign currency in-flows, it triggers exchange rate pressures or hampers opportunities for growth, especially if monetary and fiscal policies have to be adjusted to counter the external imbalances. The shock of weak global demand is transmitted to Rwandan's financial sector indirectly through the balance sheet of firms and households that banks lend to. Revenues of firms in sectors with material and direct exposure to foreign demand, including hotels, air transport and tourism, are depend on foreign demand. The total Rwandan banking sector lending to these sectors (Hotels; tourism; air transport) stood at 20.1 percent as at end June 2020. In the prevailing conditions of lower external demand, firms in these sectors are significantly performing below their potential, with little or no revenues to service their outstanding loans and or less willing or liable to secure new loans from banks. This increases credit risk for banks and could induce losses and capital erosion if these firms permanently fail to service their loans. The reduction of foreign exchange earnings due to weak external demand also directly affects the Net Open Position (NOP) of banks or increases FX liquidity risks for banks. In view of this, the projected global demand recovery by the IMF offers strong positive levers to Rwanda's economic recovery and sustained financial stability.

The Rwandan financial system remains less directly susceptible to the developments in the global financial markets because of its limited integration to the global financial system and its structure with domestically funded banks dominating the financial system. Foreign firms total investment in Rwanda's bond market stood at 13 percent of total bond investment as at end June 2020), while total portfolio flows only account for 6 percent of total financial flows. Unlike in developed countries, the banking sector in Rwanda plays the biggest role to finance the economy than the financial market. For example, the depth of banking sector, which measures the size of the banking sector relative to GDP stood at 37.3 percent in 2019, while the depth of the capital market measured as the proportion of the capital market capitalization relative to GDP stood at 32.7 in 2019. This prevents the contagion from global financial markets mainly channeled through volatile stock markets and capital reversals. Moreover, Rwandan banks source of funds are from domestic market— with domestic deposits accounting for 74.4 percent of total liabilities, while foreign borrowings account for only 1 percent of total liabilities. Nevertheless, favorable global or regional financial conditions offer room for capital raising, especially during a pandemic like this one.

4 Domestic Macroeconomic Condition

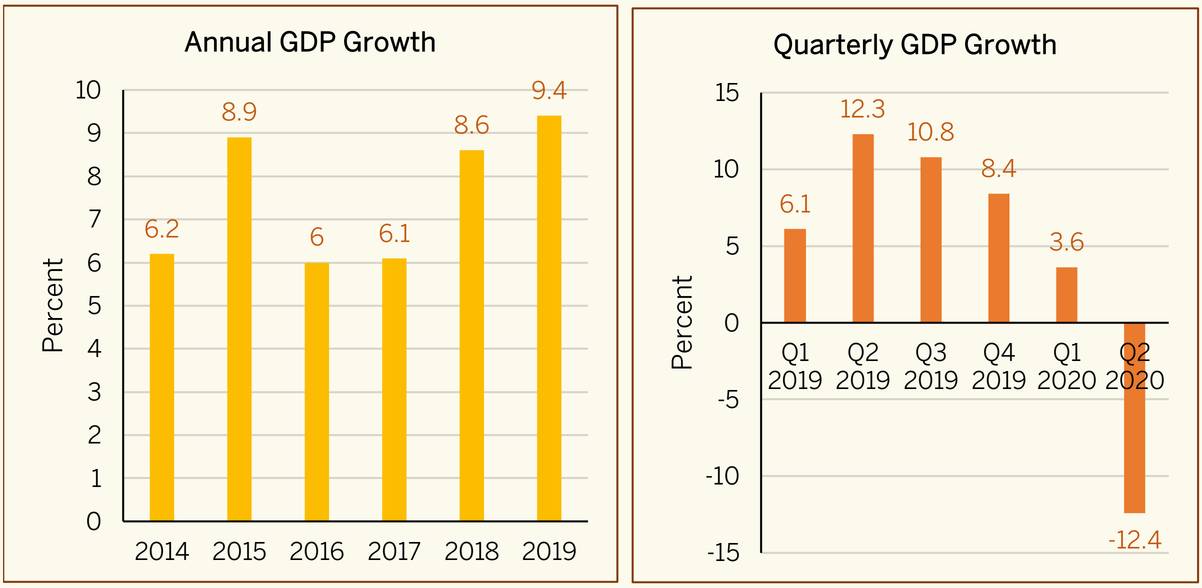
The macroeconomic conditions deteriorated in the first half of 2020 due to COVID-19 and the measures taken to contain its spread. The economy faced the deepest contraction as production in all sectors declined. To the financial sector, the downturn of the economy increased the credit risk as corporate and household balance sheet were impaired by the measures implemented to contain the spread of the virus. Signs of improved economic performance since Q3 2020 are however evident. Sections below provide details of the macroeconomic conditions and their implication to financial stability.

The Rwandan economy contracted in Q2 2020 on the back of COVID-19 outbreak and the necessary measures taken to contain its spread. Since the outbreak of the first case of the virus in March 2020, the Government of Rwanda took necessary steps to stop its spread, including implementing a total lockdown in in April and May for non-essential services. Although, these measures were effective to contain the spread of the virus, they significantly affected the Rwandan economy with real GDP for Q2 2020 contracting by 12.4 percent, the lowest in the recent past (Figure 2). The industry and service sectors were most hit with 19 percent and 16 percent contraction, respectively. This shock on the economy elevated vulnerabilities to the financial sector as it negatively affected the balance sheet of corporates and households and reduced their capacity to meet their loan service obligation. Although banks and microfinance institutions responded by restructuring 39 percent and 23 percent of their loan portfolios respectively of their clients affected by COVID-19, it is regarded as the temporary measure while stability of the financial sector rests on the speed of economic recovery. In this context, the outlook of financial stability largely rests on the trajectory of economic performance in the next 2 years, as well as policy measures taken to handle these risks.

Monetary and fiscal policy measures rolled out supported the businesses and households to navigate through the early months of the pandemic. The Government provided fiscal support for individuals and businesses affected by the COVID-19 pandemic. The largest fiscal measure has been the establishment of the Economic Recovery Fund (ERF) on top of other tax relief measures. The ERF aims at supporting businesses by providing financial support to the borrowers mostly affected by the pandemic and allowing them to retain their staff (details of the ERF framework as summarized in the policy section of this report). Monetary policy was accommodative and the reduction of reserve requirement (from 5 percent to 4 percent) released FRW 23 billion into the system providing additional liquidity for banks to lend and meet their customers' deposit withdrawal needs. The Extended Lending Facility for Banks announced by the NBR in March 2020 provided an additional FRW 5 billion of liquidity to the banking system.

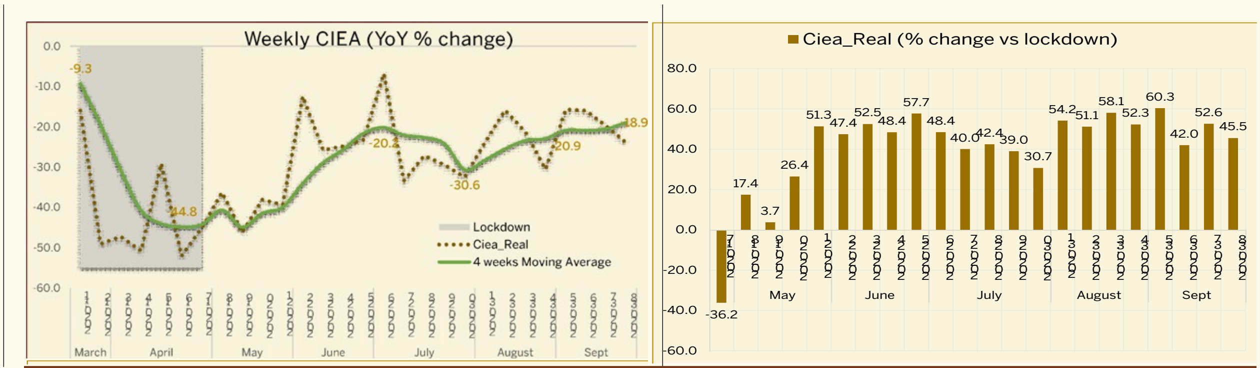
Appropriate policy response and the gradual reopening of the economy have revitalized economic performance since the third quarter of 2020. In fact, the NBR composite index of economic activities, a high frequent indicator of non-agriculture economic activities, indicates improvement of economic activities in Q3 2020 (Figure 3). The recent plan to open schools will also support this economic recovery. Despite this improvement, economic sectors dependent on external demand continue to weigh below their potential in line with the prevailing travel restrictions. To the financial sector, economic recovery will support the recovery of restructured loans and offer investment opportunities for financial institutions.

Figure 2: Real GDP Growth (Y-o-Y)



Source: NISR Data

Figure 3: High Frequent Economic Indicators



Source: NBR, Research Department

INFLATION %

Headline Inflation

8.6%

IN THE FIRST 9 MONTHS OF 2020

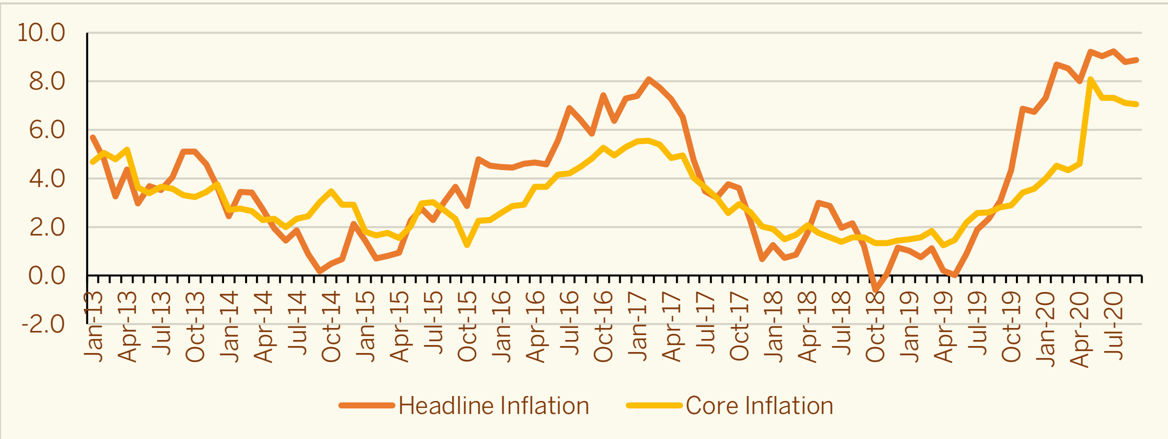
FROM

1.6%

IN THE SAME PERIOD OF 2019

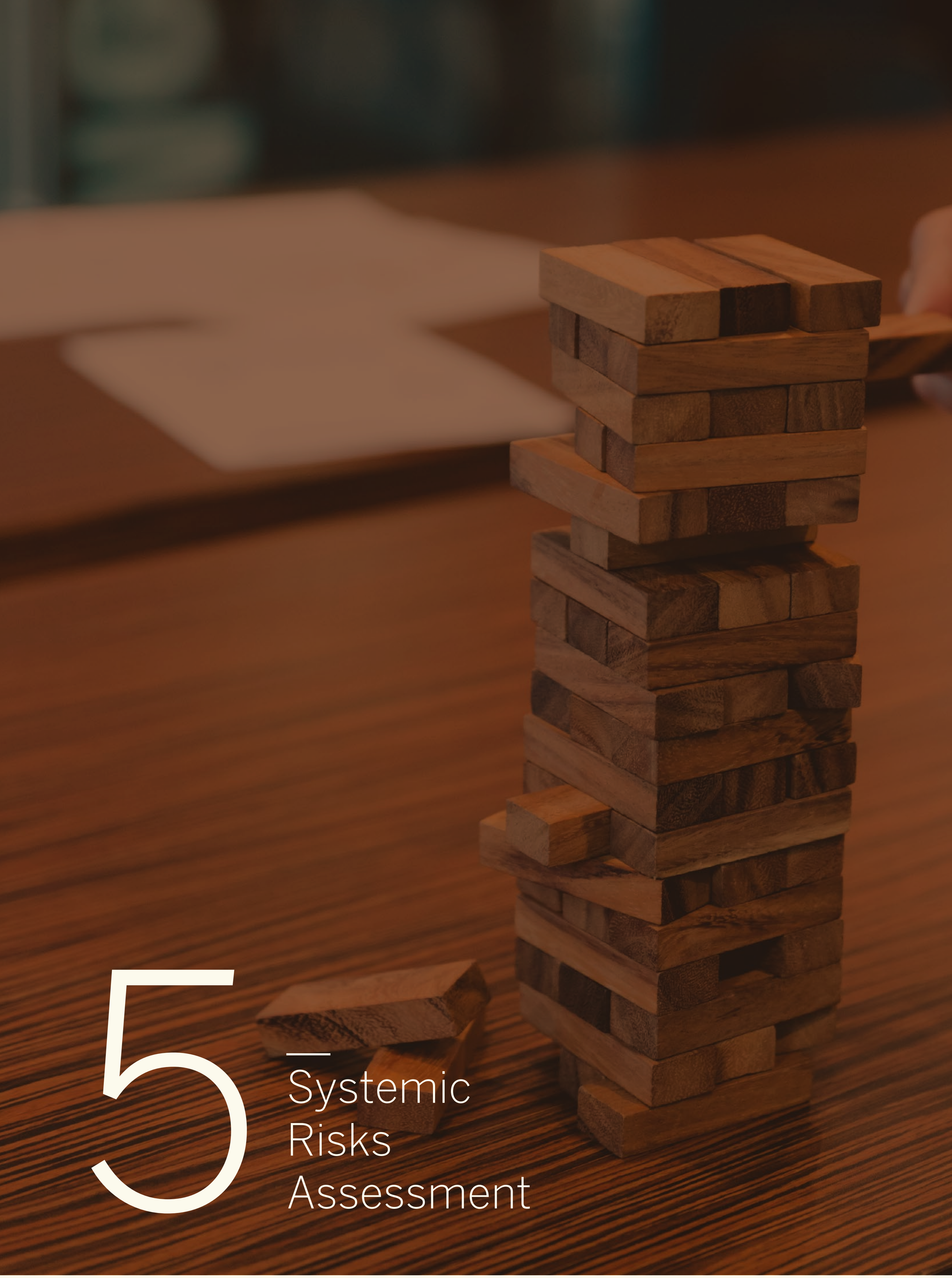
Inflation picked up in the first nine months of 2020 due to short-term supply shocks on transport and food prices, though it is expected to moderate in 2021. Headline inflation averaged at around 8.6 percent in the first 9 months of 2020, up against 1.6 percent registered in the corresponding period of 2019 (Figure 4). The uptick in headline inflation was reflected in its main components including food inflation that averaged around 14.1 percent in the first nine months of 2020, from an average of -1 percent in same period of 2019. Growth of transport prices also picked-up to average of 13.8 percent in the first nine months of 2020, up from an average of .2 percent in same period of 2019. Inflationary pressures are expected to wane down in 2021 due to better food harvest, stable transport prices and, general weak domestic demand. Inflation is relevant to the financial sector or financial market because it determines the real returns on investment, and so could encourage or discourage long-term saving and investment depending on the direction it is taking, its magnitude and its permanency. Banks or financial institutions therefore consider the rate of inflation while pricing their products (e.g., loans). The NBR expects the inflation to oscillate around 5 percent in the medium-term— a level fair enough for long-term saving and investment.

Figure 4: Inflation Development (Percentage Growth, Y-O-Y)



Source: NISR Data

Exchange rate remained relatively stable in the first seven months of 2020 as the reduction in export earnings were matched by reduction of import bill due to lower economic activities. As at end July 2020, compared to the US dollar, the Rwandan franc weakened by 2.3 percent almost the same depreciation as July last year (2.6 percent). Rwanda's exports receipts rose by 9.1 percent in the first half of 2020, amounting to USD 591.9 million up from USD 542.3 million a year earlier, while during the same period, imports of goods went up by 11.0 percent, y-o-y, to settle at USD 1,561.4 million as a result of rising demand of food products and increased imports of non-monetary gold for refinery. As economic recovery strengthens, however, the increase in import demand could exert pressure on exchange rate, especially if exports don't recover fast enough. Nevertheless, the recent improvement in global commodity prices offer optimism that pressures could be moderate. To Rwanda's financial sector, direct exposure to exchange rate shocks remain minimal— total banking sector foreign currency denominated loans is just 12.6 percent of total loans, while microfinance institutions don't lend in foreign currency. To mitigate Banks' credit risks related to foreign currency denominated loans, the NBR regulation also restricts Banks' FX lending to only firms whose income is in foreign currency.



5 — Systemic Risks Assessment

In pursuing financial stability, the NBR employs both micro-prudential and macro-prudential supervision of the financial sector. From a macro-prudential perspective, the NBR monitors developments in systemic risks facing the financial sector— these are risks, whose materialization could disrupt the financial system with negative consequences on the real economy. Systemic risks are assessed from the perspective of banking because of its large size and interconnectedness with the other parts of the financial system— insurance; micro-finance and pension. Systemic risks are assessed from different dimensions including assessment of economic shocks or particularly performance of sectors largely financed by banks; build-up of imbalances on the balance sheet of banks; loan concentration trends; performance of Domestically Systemically Importance Banks (D-SIBs). Systemic risks increased over the period under review because of the COVID-19 shock on the economy and the main one relates to increased credit risk related to restructured loans due to COVID-19. The sufficient capital and liquidity buffers held by banks indicate that the financial sector will remain resilient and capable of absorbing shocks. Paragraphs below provide details on each risk and measures taken to contain it.

Elevated credit risk caused by the COVID-19 crisis is the major systemic risk facing the financial sector.
The emergence of COVID-19 has caused a fundamental change to the viability of businesses in many sectors of the economy that could give rise to credit impairments. Evidence of this is contraction of the economy by 12.4 percent in Q2 2020 and the significant loan restructurings performed by banks (39 percent of loan portfolio) and MFIs (23 percent of loan portfolio). The protraction of the prevailing COVID-19 in 2021 could cause significant hikes in NPLs and reduction of capital in several banks. On a positive note, the assessment done by the NBR indicates that capital and liquidity buffers built by banks in the recent past can absorb a sizeable portion of losses on a going concern. As at end June 2020, liquidity of banks was more than double of the prudential requirement (LCR was 253 percent, against 100 prudential requirement), while the CAR of banks was also 23.7 percent (against 15 prudential minimum requirement). The NBR's supervisory approach focusing on this risk entails, close monitoring of the performance of loan portfolio of regulated institutions, enforcing appropriate classification and provisioning, and requiring capital restoration plans for undercapitalized institutions. Other monetary and fiscal policies to support economic recovery are also expected to mitigate this risk.

Risks related to high banking sector exposure to the mortgage sector were increased by the COVID-19 shock.
Banks' total exposure to mortgage sector constitute 34 percent of total bank loans, with around 10 percent of this related to commercial real estate. In addition to this, houses and plots are the main collaterals held by banks against other types of loans. These two factors expose the financial sector to the real estate sector performance. In context of the prevailing COVID-19 shock, risks from the real estate are expected to increase for two reasons: First, the downturn of the economy is expected to compress income of commercial real estate business through less rent income— rent, the primary source of income of real estate businesses tend to follow the development in real sector. Reduction of rent income could hamper their capacity to service loans. As at end June 2019, the NPLs ratio for the commercial real estate loans had increased to 9.3 percent from 3.6 percent in June 2019 and 5.1 percent in December 2019. Moreover Banks also restructured FRW 343 billion worth of mortgage loans (i.e., 42 percent of the entire mortgage portfolio) between April and June 2020. The real state price index produced by the NBR based on sold properties to capture developments in real estate property prices have also indicated that property prices are declining since the last quarter of 2019 (Figure 5). Property prices are prone to further declines in context of prevailing low domestic demand. Lower property prices increase credit risk for banks by lowering the value of collaterals they possess. In context of current property prices, the NBR allowed banks a 1 year extension to hold properties on their balance sheet before disposing it off- in anticipation that the property prices would recover. The NBR is currently undertaking a survey to understand the full impact of COVID-19 on commercial real estate business. The findings from this survey will inform further policy actions to mitigate this risk.

the NPLs ratio for the commercial real estate loans had increased to

9.3%

END JUNE 2020

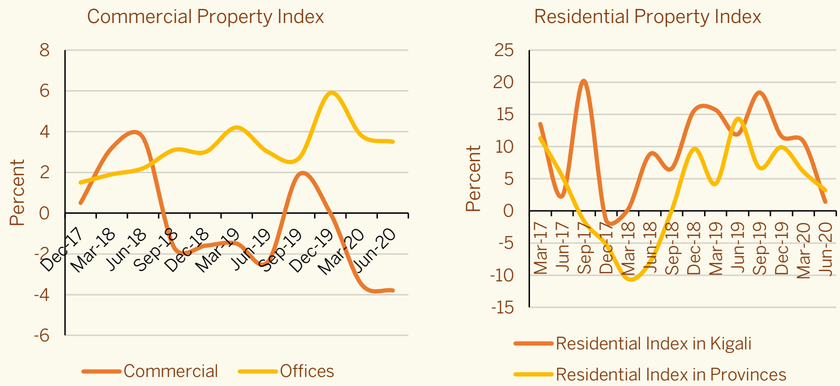
COMPARED TO

3.6%

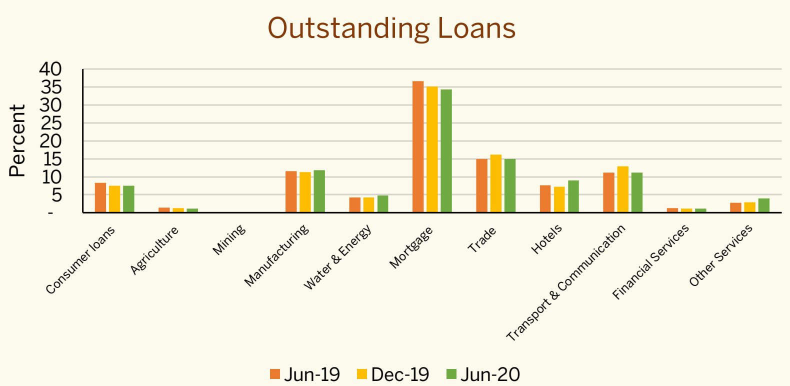
IN JUNE 2019

On a positive note, however, for the last 3 years banks are cognizant of the risk and are gradually diversifying their new investments to other sectors like manufacturing (Figure 6). In support of this diversification and reducing the risk, the NBR also established Loan-to- Value (LTV) limits in 2019 at 80 percent for commercial properties and non-primary residential property. The LTV of 80 percent means that the borrower should contribute 20 percent of the housing project, before the bank comes in to finance the remaining 80 percent. The NBR will regularly review and adjust the LTV limits based on the extent of the risk.

Figure 5: Real Estate Price Indices



Source: NBR Statistics Department using data from Rwanda Land Management and Use Authority



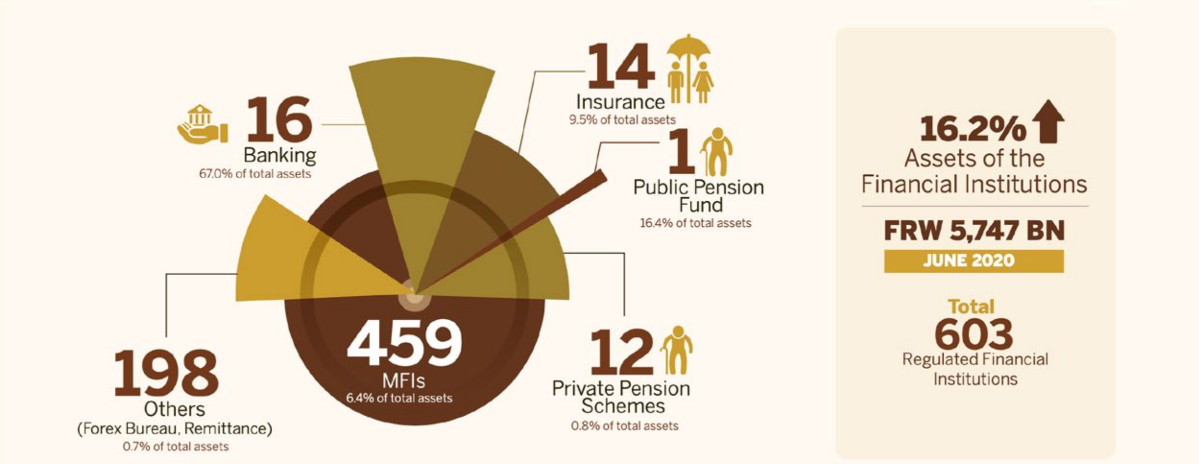
Source: NBR, Financial Stability Directorate

The funding concentration risk remains another key risk facing the banking sector. Although Rwandan banks are largely financed from resident deposits, believed to be stable compared to market funding, the concentration of these deposits exposes banks to liquidity risks. As at end June 2020, the share of top 20 depositors in the banking sector accounted for 39.8 percent of total deposits of banks, from 37.4 percent in June 2020. These large depositors are mainly the Social Security Board (RSSB); insurance companies; microfinance institutions and other large corporates. Such a concentrated deposit structure exposes banks to liquidity risks in case of significant and sudden withdraw of funds by the large depositors. The safeguard against this risk is that banks keep high liquidity buffers capable of absorbing a sizeable outflow shock. To control this risk, also, through the Annual Internal Liquidity Adequacy Assessment Process (ILAAP) reports prepared by banks, the NBR expects banks to think through deposit concentration risk and other liquidity risk scenarios and develop a contingency plan to handle those risks. Nevertheless, the long-term solution to this risk is for banks to diversify their deposit base. National efforts to scale-up the saving culture will support this process.

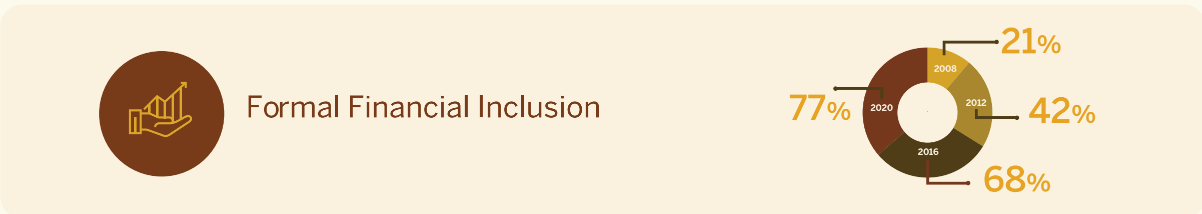
Domestic Systemically Important Banks (DSIBs) hold adequate capital positions. These are banks whose failure might trigger a financial crisis given their size, complexity, connectedness, and substitutability and cross boarder relationships. The NBR identified 6 DSIBs in its last assessment and all met the minimum capital requirement, including the DSIB capital surcharge. The average CAR for the 6 DSIBs stood at 23.2 percent as at end June 2020. The 6 identified DSIBs were categorized in buckets based on the extent of their systemic importance. In view of this, 5 banks were required 0.5 percent additional capital, while 1 bank was required 0.8 percent additional capital. All these banks exceeded these additional capital buffers as at end June 2020.

6 Performance of the Financial Sector

The financial sector remained resilient in the first 6 months of 2020 against the COVID-19. Overall, financial institutions entered the crisis with sufficient capital and liquidity acquired mainly through retained profits over the years. The adoption of international regulatory standards (Basel II, and Basel III) supported this resiliency. The financial sector also played a crucial role in supporting households and firms during this period, first by activating remote non face-to-face mechanisms of serving their customers even during the total lockdown period. In addition, banks deferred loan repayments for borrowers in cognizance of the financial strains they were facing. Sections below summarize performance of the financial sector as at end June 2020, policy measures taken by the NBR to sustain stability of the financial sector and the outlook of the sector.



The financial sector remains dominated by the banking sector which accounts for 67.0 percent of the total financial sector assets as at end June 2020 (Table 3). The banking sector is not only the largest but also a systemically important sector based on its interconnectedness with the rest of the sub-sectors. The combined deposits of microfinance, insurance and pension funds accounted for 23 percent of banking sector deposits as at end June 2020. The pension sector comes in second place with 17.2 percentage share the financial sector assets. The pension sector is dominated by the mandatory public-defined benefit pension scheme (RSSB) with 95 percent of the pension sector assets (the 12 private pension schemes account for 5 percent of pension sector assets). The insurance and microfinance sectors account for 9.5 percent and 5.7 percent, respectively, of the financial sector assets, while the rest (foreign currency dealers, remittance companies and lending-only institutions) account for the remaining 0.5 percent.



The financial sector is becoming more inclusive as revealed by the recent FinScope survey (2020). This survey done every 4 years, indicated that the percentage of adult population in Rwanda served by the formal financial sector (i.e., regulated sector) increased from 69 percent in 2016 to 77 percent (5.5 million adults) in 2020. These are adults that have or use formal financial products and services, including banking sector and other formal (non-bank) financial products/services from insurance firms, Mobile Network Operators (MNOs). The target of the Government of Rwanda is to increase the proportion of formally served adults to 100 percent by 2024 as elaborated in the National Strategy for Transformation (NST 1). The formal inclusion gains in the last four years (2016-2020) was driven by increase of bank account holders (from 1.1 million in 2016 to 2.6 million in 2020); increased uptake of mobile money (4.4 million in 2020, against 2.3 million in 2016); U-SACCOs (2.4 million account holders in 2020, against 2 million in 2016); more insured adults (1.2 million in 2020, from 0.5 million in 2016) and; increased account holders in other MFIs (0.7 million in 2020, from 0.3 million in 2016). Further formal financial inclusion gains are expected to be supported by the recent increased uptake of mobile and contactless transactions to limit the spread of Coronavirus.

Table 3: The Structure of the Financial System

Regulated Financial Institutions	Jun-19			June 2020		
(Assets in FRW Billion)	Number	Assets	% of TA	Number	Assets	% of TA
Banks	16	3,252	65.7	16	3,854	67.0
Commercial Banks	11	2.622	53.0	11	3,142	54.7
Microfinance Banks	3	76	1.5	3	66	1.15
Development Banks	1	247	5.0	1	265	4.6
Cooperative Banks	1	307	6.2	1	381	6.6
Pension Schemes	13	877	17.7	13	990	17.2
Public	1	837	16.9	1	941	16.4
Private	12	40	0.8	12	49	0.8
Insurers	14	477	9.6	14	544	9.5
Life	3	49	0.9	3	52	0.9
Non-Life	11	428	8.6	11	492	8.6
Microfinances	457	313	6.3	459	330	5.7
U-SACCOs	416	138	2.8	416	139	2.4
Other SACCOs	22	89	1.8	24	97	1.7
Limited Companies	19	86	1.7	19	94	1.6
Foreign Currency Dealers & Remittances	99	8	0.2	97	9	0.2
Forex Bureau	85	8	0.2	83	9	0.2
Remittance Companies	8	-	0.0	8	-	0.0
Money Transfer Agencies	6	-	0.0	6	-	0.0
Lending only Institutions	4	18	0.4	4	20	0.3
Grand Total	603	4,945	100	603	5,747	100

Source: Financial Stability Directorate

7 The Banking Sector

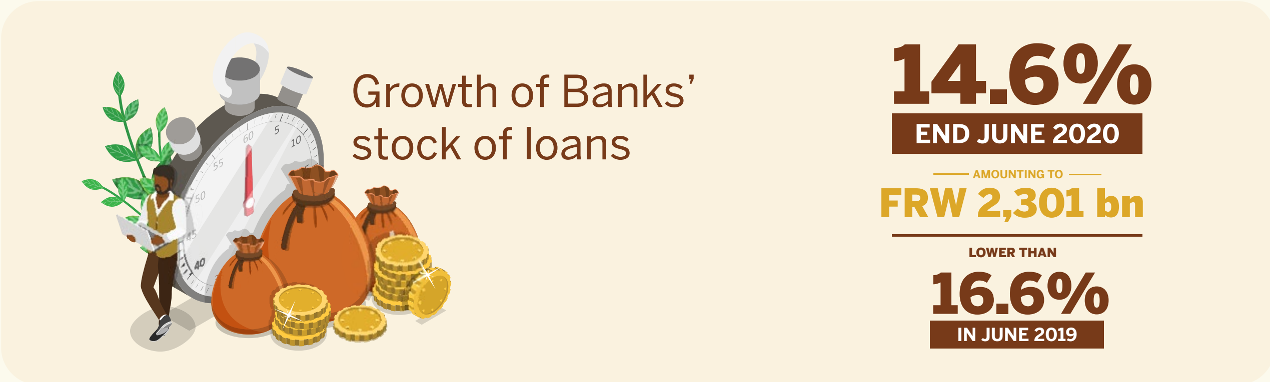
The Rwandan Banking sector is composed of 11 commercial banks, 3 microfinance banks, 1 development bank and, 1 cooperative bank. The sector serves its clients through a network of 200 branches; 150 sub-branches and outlets as well as, 4,706 agents and digital platforms like internet banking and mobile banking. The banking sector is predominantly private and subsidiaries of foreign banks. 14 out of 16 banks are private banks based on majority shareholdings. Further, 11 out of 16 banks are subsidiaries of foreign banks and holding companies (mainly from Africa).

Financial intermediation remains the core business of banks with 56.7 percent of their assets being loans as at end June 2020. The other two key earning assets for banks are Government securities- treasury bills and bonds (18 percent of total assets) and; placements in foreign financial institutions (4.7 percent). Other assets include cash and reserves at central bank (7.1 percent of total assets); due from other financial institutions in Rwanda (6.7 percent); fixed assets (4.2 percent) and other assets (2.4 percent). Bank lending is primarily to the private sector with around 95 percent of stock of loans to private entities- Public Enterprises account for 5 percent of total stock of banking loans. The predominance of loans in banking sector assets indicates the high exposure of the banking sector to performance of firms and households.

Banks maintain a stable funding profile with 76.8 percent of their liabilities being deposits. Interbank and foreign borrowings, the two secondary sources of funds for banks account for 18.1 percent and 0.7 percent, respectively. Other liabilities account for the remaining 4.3 percent of total liabilities. A stable funding profile is even more important during current global financial market distress due to COVID-19 global pandemic. Customer deposits are less sensitive to fluctuations in the global financial market investors' sentiments. Maturity of banks' deposits however remain short-term, which limits their long-term lending—the share of term deposits in total deposits was 41.5 percent as at end June 2020, compared to demand deposits at 58.5 percent.

Assets of the banking sector continued to grow in the period ended June 2020 on the back of strong economic performance especially in the second half of 2019. The system-wide total assets increased by 18.5 percent (y-o-y) as at end June 2020 to FRW 3,853 billion (42 percent of GDP), up against the 15.1 percent registered in June 2019 mainly driven by deposit mobilization, retained earnings, and capital injection. The high level of net profits earned in 2019 (FRW 75.7 billion) due the robust economic performance and the decision to withhold dividend distribution supported growth of the banking sector assets. The other aspect that increased banks assets is paid-up capital; banks injected FRW 43 billion in the period ended June 2020, up from FRW 31 billion injected in corresponding previous period. The strong growth of deposits by 17.8 percent in June 2020, up from 13.2 percent in June 2019, also supported the growth of banking sector assets. Growth of deposits was largely supported by the Government net fiscal injection in Q2 2020 (at FRW 99.5 billion in Q2 2020, up from FRW 7.9 billion in Q2 2019). It has been established that development in Government net fiscal injection (domestic spending) greatly influences growth of banking sector deposits.

Growth of the banking sector loan book slowed (outstanding loans), owing to reduced lending in the first half of 2020. Growth of Banks loans as at end June 2020 decelerated to 14.6 percent (y-o-y) to FRW 2,301 billion, compared to the 16.6 growth registered in June 2019. This moderation is largely attributable to weak lending in the first half of 2020, especially in the month of April (during lockdown) when all non-essential businesses were closed. In total, banks approved FRW 500.1 billion new loans in H1 2020, 50.1 billion less, compared to the FRW 550.8 billion approved in H1 2019. As expected, due to economic lockdown in April and May as well as the post-lockdown sluggish business conditions, demand for loans (in value) from both households and firms in H1 2020 dropped by 12.3 percent (y-oy) —i.e., from FRW 648.6 billion in H1 2019 to FRW 568.8 billion in H1 2020. In terms of volume, demand for loans during the same period declined by 37.9 percent (from 365,129 in H1 2019 to 226,484 in H1 2020).



The Banking sector direct exposure to sectors severely impacted by COVID-19 is sizeable and remains a key risk to the financial sector. Banks' share of loans to severely affected sectors (commercial real estate; restaurants and hotels; transport; tourism; education; mining) stood at 34.3 percent of the banking sector loan book as at end June 2020. Although business progressively resumed after the lockdown in May 2020, businesses in these sectors remain relatively constrained by existing border closures and international travel restrictions (these include hotel & tourism), while others like commercial real estate remain constrained by low trade activities. Although the banking sector exposure to the mining sector is still small (at 0.1 percent of total loans), the recent decline of mineral prices on international market puts stress on these loans. In respect to this, the balance sheet of the banking sector in the near-term, will very much depend on resumption of economic activities in these sectors and risk management measures taken by the financial institutions against these risks. In this circumstance, banks will need to strike the right balance between growing their balance sheet through increased lending and containing the credit risk.

Monetary, supervisory/regulatory and fiscal policies taken in the last 3 months have been and will continue supporting banks and bank clients to navigate through this COVID-19 pandemic. At the early stages of the pandemic in March 2020, the NBR established an Extended Lending Facility of FRW 50 billion to support banks facing liquidity stress due to COVID-19 outbreak. Since its inception, two banks have benefited from this facility at a tune of FRW 5 billion. This facility will run up to October 2020, with the possibility to extend it if deemed necessary. The monetary policy stance in the last 2 quarters was also supportive to banks with the NBR reducing its Central Bank Rate (CBR) by 50 basis points in April 2020 from 5 percent to 4.5 percent. The NBR also reduced the Reserve Requirement (RR) by 100 basis points from 5 percent to 4 percent, a decision that released FRW 23 billion additional liquidity for banks to use for lending to the private sector as well as to meet their customers' deposit withdrawal obligations. The NBR's efforts to support banks is also reflected in the policy to suspend dividend distribution for profits generated in 2019— a decision aimed at beefing -up banks' capital and liquidity position. The fiscal policy initiatives taken also directly and indirectly supported banks/or financial sector in general. In June 2020, Government launched the Economic Recovery Fund (ERF)1 – a FRW 101 billion fund expected to support businesses most severely affected by the COVID-19 pandemic through low interest working capital loans, for large enterprises (FRW 30 billion), Small and Medium Enterprises (FRW 15 billion), microbusiness (FRW 3 billion), and SMEs guarantee scheme (FRW 3 billion) and a hotel refinancing facility (FRW 50 billion). This is also expected to pump additional liquidity in the system.

This pandemic emphasizes the need for banks to diversify their loan portfolio. Banks' loan concentration to sectors like mortgage and trade although recently declining still remains a major risk to banks (Table 4). As at end June 2020, the combined share of loans to mortgage and trade accounted for close to 49.3 percent of the entire loan book of the banking sector (mortgage industries at 34.3 percent and trade at 15.0 percent). Distribution of banking sector loans to other sectors was as follows as at end June 2020: manufacturing (11.8 percent); Transport and communication (11.1 percent); restaurants and hotels (9 percent); personal loans (7.5 percent); water & energy (4.8 percent); other services (4 percent) agriculture (1.2 percent); mining (0.1 percent).

In March 2019, the NBR implemented Loan-to-Value (LTV) limits (80 percent for commercial real estate and secondary residential houses - this means that banks should finance at maximum 80 percent of the total cost or value of commercial building project/ or second residential house, and the borrower contributes 20 percent) in order to induce banks to diversify and reduce their exposure to mortgages. The Financial Stability Committee (FSC) of the Central Bank will regularly review this LTV limit based on developments in property prices and growth of mortgage loans.

Table 4: Outstanding Loans by Activity Sector

Activity Sector	% Total Loans			
	Jun-17	Jun-18	Jun-19	Jun-20
Consumer loans	7.9	8.4	8.3	7.5
Agricultural & livestock	1.8	1.5	1.5	1.2
Mining activities	0.1	0.2	0.2	0.1
Manufacturing	9.7	10.5	11.5	11.8
Water & energy	2.6	2.6	4.3	4.8
Mortgage industries	34.5	37.1	36.7	34.3
Trade	19.4	17.2	15	15
Restaurant & hotel	10.2	8.1	7.6	9
Transport & communication	8.7	9.8	11.1	11.1
OFI &Insurance	1.7	1.3	1.2	1.2
Other Service sector	3.3	3.3	2.7	4

Source: NBR, Financial Stability Directorate

Banks maintain sufficient capital buffers capable of absorbing losses. The system-wide total capital adequacy ratio stood at 23.7 percent as at end June 2020, against the 15 percent prudential minimum. Moreover, banks maintained high quality capital with core capital (shareholder's equity and retained earnings) ratio at 22.3 percent as at end June 2020, against the 10 percent prudential minimum. From a solo perspective, all banks continued to meet the minimum prudential capital requirement.

The stress tests performed on the banking sector in June 2020 demonstrated that the banking sector is still resilient to the adverse shocks, including the effects of COVID 19 pandemic on loan portfolio. According to stress test results, the banking sector has enough capital buffer to absorb adverse shocks and maintain their overall capital ratio sufficiently above the regulatory threshold of 15 percent even under a very adverse scenario. This stress test exercise was based on the effects of COVID 19 pandemic on loan portfolio, and considered the relief measures implemented by banks to assist borrowers who had their projects distressed by the pandemic, and the subsequent regulatory changes. As mentioned, since the onset of COVID 19, banks were allowed to restructure loans which were affected the pandemic. Restructuring entailed the loan holiday for an averaged period of 4 months after which borrowers shall start making payments. The test carried out assumed the 10th percentile of these restructured loans would default by September 2020, 50th percentile would default by December 2020 while 75th percentile of them would default in December 2021. While these assumptions are based on the macro framework projections of the credit growth (by 10.2 percent in 2020, and 10.3 percent in 2021), they disregard the incentives made by the Government aimed at boosting the economic activities and that the economy would still be growing at 2 percent in the following two years. Based on the above, it was observed that the NPLs ratio would increase from 5.5 percent in June 2020 to 9.8 percent, 26.8 percent and 33.6 percent in September 2020, December 2020 and December 2021 respectively. The resulting effect on solvency showed that CAR would reduce by 2.50 percentage points, 4.90 percentage points and 6.50 percentage points respectively in September 2020, December 2020, and December 2021. This also assumed the pre COVID 19 pandemic capital treatment, and provisioning practices.

The leverage ratio for the banking sector averaged at 13.6 percent as at end June 2020, reflecting strong solvency of the sector from a broader on and off balance sheet consideration. During the current COVID-19 economic shock, these solvency buffers offer the first line of defense for the banking sector to absorb the credit losses to a certain extent while continuing to supply credit to the economy. In fact, the resilience of the banking sector since the outbreak of the virus early this year, is partly attributable to the adequate capital buffers held by the banking sector in the recent past. Capital buffers of banks in the recent past were beefed-up by the NBR's adoption of international regulatory standards (Basel II & Basel III) since 2018, which increased the quantity and quality of capital that banks should hold relative to their risks. To support banking sector capital position and its capacity to continue lending to the real economy during the current economic down turn induced by COVID-19, the NBR in March 2020 took a decision to suspend distribution of dividends from profits generated in 2019.

The significant loan restructurings done by banks in the second quarter of 2020 (39 percent of their loan portfolio) did not necessarily affect the capital levels of banks due to the NBR's guideline on treatment of restructured loans. The guideline stresses in computation of regulatory capital, the risk weights assigned to COVID-19 related restructured loans must be similar, and not better than, their weights before the restructuring. The same guideline also provided that restructured loans should not be classified as non-performing for the period of the provided moratorium. However, the guideline stresses that Banks continue considering loan loss provisions in accordance with IFRS9 principles, which will result in increased provisioning, 50 percent of which will be added back to Tier II capital.

Banks hold substantial reserves of liquid assets to meet customers' funding needs. Liquidity buffers refer to banks' stocks of liquid assets such as cash, central bank reserves, or government debt, which can be easily used to meet unexpected cash outflows. Banks are inherently vulnerable to liquidity risk due to the maturity transformation role they play. To address this issue, the NBR requires banks to maintain sufficient un-encumbered liquid assets available to meet their projected outflows. As at end June 2020, banks maintained sufficient liquidity buffers as the Liquidity Coverage Ratios (LCRs) – which measure their holdings of liquid assets relative to the potential outflows of funding that could occur in in 30 days stressed period was at 253 percent, well above the regulatory minimum of 100 per cent. On a solo basis, all banks met this liquidity requirement. Banks also finance their assets using stable resources as the Net Stable Funding Ratio that compares the banks' stable funds to their long-term assets stood at 164.3 percent as at end June 2020, against the 100 minimum prudential requirement. The Liquidity position of banks in the first half of 2020 was buoyed-up by the reduced cash-withdraws during and post lockdown, as well as a gradual increase of deposits since May 2020 after the government eased some of the lockdown restrictions.

Liquidity risks for banks so far relate to delayed cash inflows from restructured loans and the structural deposit concertation in banks. By restructuring 39 percent of their loan portfolio (i.e., FRW 978 billion), banks had to forego 28 percent of their monthly cash-inflows (i.e., FRW 46.5 billion) for the moratorium period which ranges from 3 to 6 months. As at end June 2020, banks' liquidity positions were not affected by this loss of cash flows as this was counterbalanced by the strong growth of deposits and slowdown of new lending. However, going forward, it's a risk, that banks have to manage in their liquidity planning. The other risk relates to deposit concentration where top 50 deposits in the banking sector account for 23.6 percent total deposits in banks. The supervisory advice to banks is that they gradually diversify their deposit base to avoid any liquidity stress that would be caused by a few large depositors' decisions to move their funds. The NBR will continue to monitor and measure these risks, as well engage banks on appropriate measures to address them. The NBR will also continue to offer short-term liquidity support to solvent banks facing short-term liquidity stress.

Nevertheless, liquidity stress tests suggests that banks are resilient to liquidity shocks in the short term. The liquidity stress test was carried out as at June 2020 with two main assumptions: First, the reduction of High Quality Liquid Assets (HQLA) by 11 percent which is the double of the current withdrawal rate (average of 5.5 percent in the first five months of 2020). This means the outflows were increased by the respective percentage. The second assumption was the decrease of inflows resulting from the loss on loans being defaulted on, by considering the percentage of the actual total deferred monthly interests and principals to total inflow from total loan portfolio (28 percent). The results of the test showed that the LCR would reduce from 253 percent to 204 percent and two banks would fall below the required liquidity requirement of 100 percent. The LCR metric is calibrated on a 30-day stress horizon.

The Non-Performing Loans (NPLs) ratio in banks remained stable at 5.5 percent in June 2020, the same level it was in March 2020 when the COVID-19 outbreak started disrupting the economic activities. The stability of the NPLs ratio doesn't necessary reflect the stability of credit risk as the stock of NPLs in banks increased from FRW 132 billion in March 2020 to FRW 142 billion in June 2020 (i.e., 10 billion increase). The NPLs ratio was stable largely because of the increase in the NPLs (amounts) was outweighed by new loans approved by banks in May and June after the lockdown- new loans approved in Q2 2020 amounted to FRW 180 billion.

The stock of NPLs in banks increased

FRW 142 bn
IN JUNE 2020

FRW 132 bn
IN MARCH 2020

The other aspect that contained the growth of NPLs ratio in banks relate to the significant restructurings that banks did in Q2 2020—FRW 978 billion (i.e., 39 percent of their loan portfolio). Most of these loans were performing loans in class 1 and 2, meaning that without the payment moratorium given, some of them would have jumped to NPLs category, hence driving up the NPLs ratio. The guideline provided by the NBR provides that Banks shouldn't necessarily classify restructured facilities as defaults/ non-performing at least for the period of the moratorium. Although not all restructured loans will default at the end of the payment moratorium, the extent of these restructured loans increased the credit risk in banks. Going forward, to preserve the solvency and the stability of the banking sector amidst this increased credit risk, the NBR will focus on effective monitoring of credit risk in banks, as well as ensure appropriate classification and provisioning.

From a sectoral perspective, the NPLs ratio remained high in four key sectors as at end June 2020 (Table 5): Trade (10.8 percent); mining (80.4 percent); other services2 (8.2 percent) and personal loans (7.4 percent). The higher NPLs ratio in the mining sector reflects one facility for a mineral company that was affected by the slowdown of global mineral prices. Nevertheless, the banking sector exposure to mining remains small (at 0.1 percent of total loans). The high NPLs ratio in the trade sector is of particular importance since loans to this sector account for 15 percent the entire loan book of banks. On the other hand, the NPLs ratio remained low in the other 4 key sectors (Table 5): manufacturing (0.6 percent); mortgage (5.5 percent); restaurants and hotels (3.8 percent); and transport &communication (1.4 percent). The NPLs ratio persistently remained low in the manufacturing sector for the last 3 quarters in a row (0.8 percent in December 2019; 0.6 percent in March 2020; and 0.6 percent June 2020) indicating potential for banks to diversify lending to this sector, with minimal risks. On the other hand, however, the low NPLs ratio in restaurants and hotels reflects one large loan approved in Q2 2020 (FRW 46 billion) that outweighed the amount of NPLs in this sector.

Table 5: NPLs Ratio by Economic Sector (percent)

Activity Sectors	NPLs Ratio (Percent)				Percent share in total NPLs
	Jun-17	Jun-18	Jun-19	Jun-20	
Personal loans	7.2	6.1	6	7.4	10.8
Agricultural & livestock	18.2	7.2	5	4.8	1.1
Mining	-	0.6	88.4	80.4	2.1
Manufacturing	9.1	13.9	1.4	0.6	1.5
Water & energy	0.1	0	0	0	0
Mortgage	6.6	5.3	3.8	5.5	36.8
Trade	12.6	11.5	15.6	10.8	31.4
Hotels	8.8	11	8.8	3.8	6.6
Transport & communication	3.2	2.6	2.3	1.4	3.1
Financial services	0.2	0.4	1.7	1	0.2
Other services	11.4	8.9	6.7	8.2	6.5

Source: NBR, Financial Stability Directorate

Profits of the banking sector increased from FRW 26.2 billion in the first half of 2019 to FRW 33.1 billion in the first half of 2020. During the same period, the Return on Assets (ROA) increased from 1.6 percent to 1.8 percent, while the Return on Equity (ROE) increased from 9.3 percent to 9.9 percent (Table 6). Banking sector profits was driven up by the accelerated lending in 2019 that drove up Net Interest Income (NII)— income that banks get from loans, from FRW 120.2 billion in the first half of 2019 to FRW 136.4 billion in the first half of 2020. On the other hand, interest expenses marginally increased from FRW 48.1 billion in first half of 2019 to FRW 56.6 billion in first half of 2020. Banks' non-interest income dropped from FRW 55.3 billion in H1 2019 to FRW 53 billion in H1 2020, largely due to low loan recovery during economic down turn and the zero fees policy on electronic payment channels introduced for 3 months since March 2020. Banks' profits are expected to contract at the end of the year, as banks make provisions for restructured loans that will not have improved at the end of the moratorium.

Profits of the banking sector increased

FRW 33.1 bn

FIRST HALF OF 2020

FRW 26.2 bn

FIRST HALF OF 2019

Table 6: Key Financial Soundness Indicators for Banks (Percent)

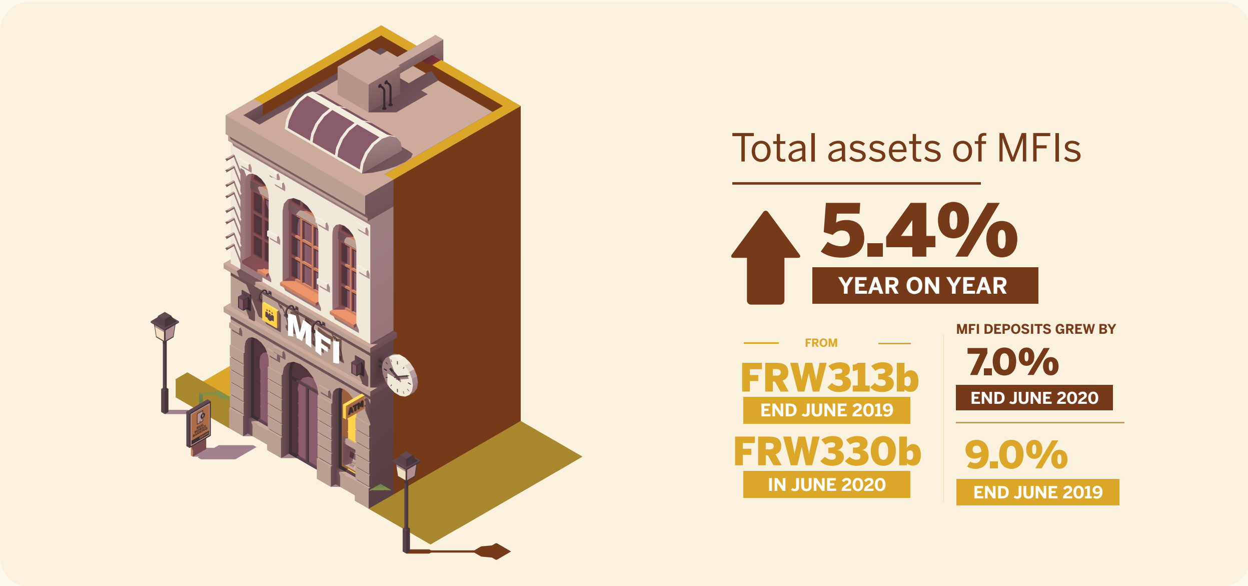
Indicators	Jun-16	Jun-17	Jun-18	Jun-19	Jun-20
Total CAR (min 15 %)	23.3	20.8	21.9	23.3	23.6
Tier 1 CAR (Core CAR)	20.7	19.2	20.1	21.8	22.3
NPLs Ratio	7	8.2	6.9	5.6	5.5
Provisions / NPLs	42.7	44.9	67.4	80.2	82.6
Return on Average Assets	1.7	1.7	1.6	1.6	1.8
Return on Average Equity	9.2	9.6	9.5	9.3	9.9
LCR (min 100%)	-	-	299.5	180.5	253
NSFR (min 100%)	-	-	224.7	164.3	164.3
FX Exposure/Core Capital (± 20%)	-1.8	-6.1	-6.1	-8.6	-6.6

Source: NBR, Financial Stability Directorate

MICROFINANCE SUB-SECTOR

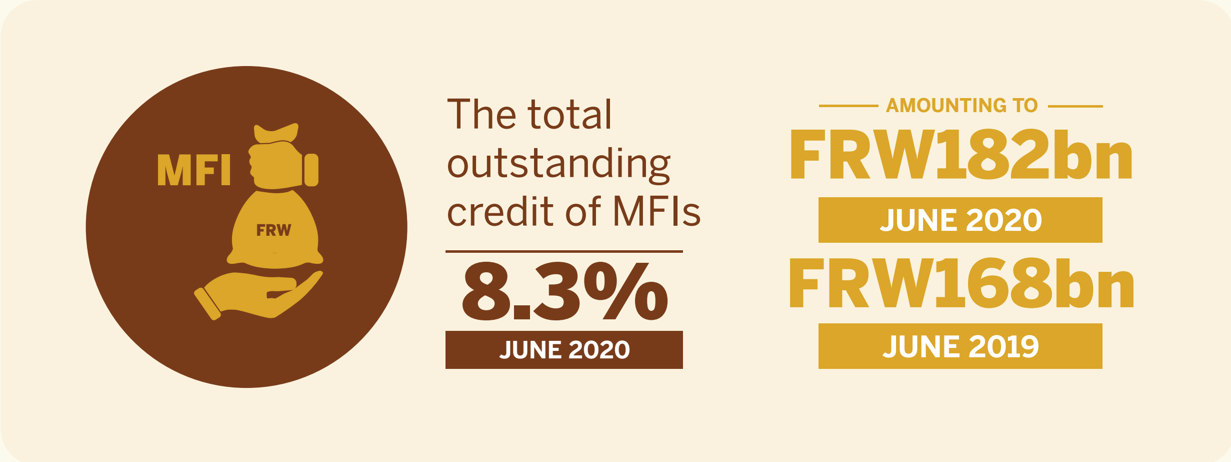
In terms of size, the microfinance sector is relatively small compared to the banking sector. As at end June 2020, microfinance sector constituted 5.7 percent of total assets of the financial sector, down from 6.3 percent in June 2019. It is comprised of 459 institutions licensed to carry out microfinance businesses of which 416 are Umurenge SACCOs (U-SACCOs), 22 non-Umurenge SACCOs and 21 Public Limited Companies (PLCs). The sections that follow summarize the performance and stability of microfinance sector during the year ended June 2020.

The growth of assets in Microfinance Institutions (MFIs) moderated during the period under review. Total assets of MFIs increased by 5.4 percent (y-o-y) —from FRW 313 billion in June 2019 to FRW 330 billion in June 2020, lower than 12.2 percent registered in the corresponding period of last year. The moderation of the growth of assets of MFIs mainly reflected the slowdown of the growth of deposits and shareholders' funds. As at June 2020, deposits grew by 7 percent compared to the growth of 9 percent registered in June 2019 while shareholders' funds moderated by 7.4 percent against 16.8 percent registered in June 2019 on account of reduced profits in June 2020.



The asset mix of the microfinance sector remained broadly unchanged. As at end June 2020, loans constituted the majority of assets of MFIs with a share of 52.0 percent, against 51.7 percentage share in June 2019. Placement in banks constituted 35.0 percent as at end June 2020 against 36.4 percent as at end June 2019. Other assets categories of MFIs include tangible assets (9.2 percent), cash (2.1 percent) and holding in government securities (1.6 percent).

The total outstanding credit of MFIs expanded by 8.3 percent year-on-year, from FRW 168 billion in June 2019 to FRW 182 billion in June 2020, compared to the growth of 12.3 percent registered during the previous year. The moderation of the growth of MFI sector loans is largely linked to two main factors: i) Increased credit risks due to COVID-19 pandemic and ii) weak credit demand associated with the disruption of businesses.



Looking at different categories of MFIs, the moderation of the growth of loans was more pronounced in U-SACCOs and PLCs, but improved in other SACCOs. Lending in U-SACCOs increased by 3.6 percent (from FRW 47 billion in June 2019 to FRW 49 billion in June 2020), against 11.3 percent growth registered in corresponding period of last year. Lending in PLCs expanded by 8.4 percent (from FRW 55.0 billion in June 2019 to FRW 60 billion in June 2020), down from 18.9 percent registered as at end June 2019. During the same period, lending in other SACCOs expanded by 11.5 percent (from FRW 65.4 billion in June 2019 to FRW 72.9 billion in June 2020), higher than the growth of 7.9 percent registered during the previous year. Stronger lending in other SACCOs is largely due to Umwarimu SACCOs (Teachers Saving and Credit Cooperative) that supported their members (teachers) with emergency loans (overdraft) to deal with the hardships caused by the COVID-19 pandemic.

With regards to funding, the emergency of COVID-19 pandemic has had an impact on funding sources of MFIs. The total deposits of MFIs grew by 7.0 percent (from FRW 167 billion in June 2019 to FRW 179 billion in June 2020), lower than 8.9 percent registered in the corresponding period of last year. The slowdown of the growth of deposits is explained by increased withdrawals by MFIs customers to meet the emergencies during economic downturn, as well as reduced new deposits from firms negatively affected by the COVID-19 pandemic. Shareholders' funds, the other key source of funds for microfinance institutions increased by 7.4 percent (from FRW 106 billion in June 2019 to FRW 114 billion in June 2020), lower than 16.8 percent registered last year. The moderation of the growth of shareholders' funds this year relates to the decline of profits. On the other hand, short term borrowings by MFIs contracted by 35.2 percent (from FRW 20.6 billion in June 2019 to FRW 13.4 billion in June 2020), against 6.5 percent registered last year, as MFIs scaled down borrowings in current context of limited investment opportunities amid weak demand for loans.

8 The Soundness of the Microfinance Sector

MFIs maintained sufficient capital and liquidity buffers to support the growth of their business and absorb losses. The aggregate CAR of MFIs stood at 34.5 percent, higher than the minimum prudential requirement of 15 percent. The sector is also sufficiently liquid with the liquidity ratio (that compares high liquid assets to deposits) at 110 percent, against the 30 percent minimum prudential requirement. Large capital and liquidity buffers are expected to support this sector to remain resilient to COVID-19 related losses.

Profits of the microfinance sector dropped from FRW 6.6 billion in the first half of 2019 to FRW 1.1 billion in the first half of 2020. The reduction of profits among MFIs relates to increased provisions (from FRW 122 million in H1 2019 to FRW 5.4 billion) due to increased NPLs, from 6.5 percent in June 2019 to 12.8 percent in June 2020. Non-performing loan among MFIs largely reflects the impact of COVID-19 containment measures on firms financed by the MFIs sector.

Profits of the Microfinance sector dropped

FRW 1.1 bn
FIRST HALF OF 2020

FRW 6.6 bn
FIRST HALF OF 2019

Similar to banks, MFIs also provided payment relief to their borrowers negatively affected by COVID-19 by restructuring 23 percent of their loan portfolio (i.e., 29.5 billion) as at end June 2020. Most of this restructurings was in-form of payment moratorium of 3-4 months on the assumption that affected business will make a turn-around in that period. The NBR guideline to MFIs on COVID-19 loan restructurings is explained in the policy section of this report. Credit risks related to these restructured loans was identified as a key risk that would challenge the microfinance sector in near-term. To safeguard stability of these institutions, the NBR will enforce proper classification and adequate provisioning for stressed loan facilities, and work with affected institutions, as well as, other Government agencies to address any identified capital shortfalls.

Table 7: MFIs Performance Indicators

Indicators	Jun-16	Jun-17	Jun-18	Jun-19	Jun-20
Assets (FRW billion)	230.3	247.7	279	313.1	330.2
Loans (FRW billion)	119.5	127.4	149.3	167.6	181.5
Deposits (FRW billion)	126	133.4	153.6	167.2	178.9
Equity (FRW billion)	69.7	82.5	90.7	105.9	113.8
Net profit/Loss (FRW billion)	4.3	-0.1	3.2	6.6	1.1
Capital Adequacy Ratio (%)	30.3	33.3	32.5	33.8	34.5
NPLs Ratio (%)	7.5	12.3	8	6.7	12.8
ROA (%)	4	-0.1	1.2	4.3	0.7
ROE (%)	13.3	-0.3	3.7	12.8	1.9
Liquidity Ratio (%)	95.1	99.1	103.3	108.8	110.1

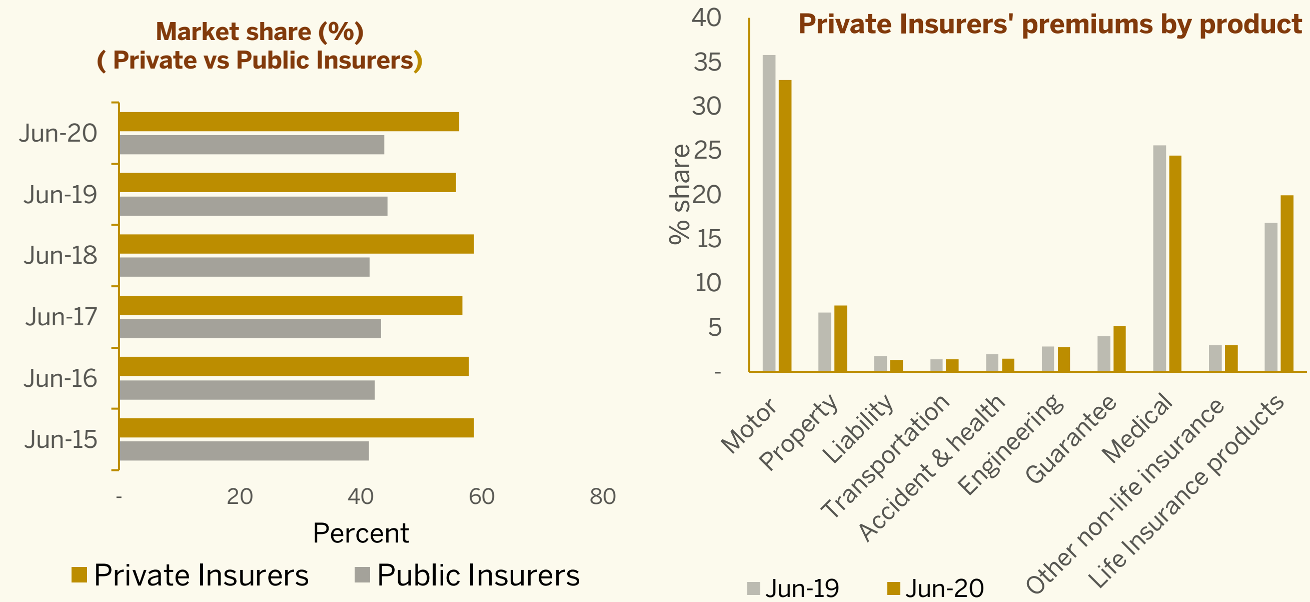
Source: NBR, Financial Stability Directorate

9 Insurance Sector

The structure and composition of the sector remains the same since the last FSR in February 2020. The sector consisted of 14 insurance companies as at June 2020. This includes 12 private Insurers (9 non-life and 3 life Insurers) with combined market share of 56 percent of the insurance industry and 2 public health Insurers (RSSB Medical and MMI). Insurance intermediaries consisted of 776 agents, 14 brokers, and 19 loss adjusters as at June 2020 from 707 agents, 17 brokers and 19 loss adjusters as at June 2019. The NBR licenses insurance brokers and loss adjusters, while insurance companies were authorized to license their agents since 2018.

Private Insurance business is composed of life insurance and non-life insurance business lines. Non-life insurance is the largest insurance business line, with around 80 percent of total premiums, while life insurance accounted for 20 percent. The non-life insurance business consists largely of motor and medical insurance products with combined share of 57.4 percent of total private Insurers premiums, reflecting the product concentration risk. The remaining 42.6 percent of private Insurers' premiums came from life insurance (20 percent); property (7.5 percent), guarantees (5.1 percent), engineering (2.8 percent), accident and health (1.5 percent), transportation (1.4 percent), liability (1.3 percent), other non-life insurance products (3 percent).

Figure 7: Insurance Market Landscape



Source: NBR, Financial Stability Directorate

Overall, there has been limited impact of the COVID-19 outbreak on the insurance sector due to three reasons: (1) Insurers' investment is largely concentrated in low risk/fixed income assets—deposits in Banks and Government securities account for 73.8 percent of insurance sector total investments; (2) Mandatory insurance products (motor & medical) account for 60% of total premiums; and (3) Insurance policies offered by our insurers don't cover pandemic risks (e.g., COVID-19). Due to these factors, assets of insurance sector continued to grow; and insurance companies continued to meet the prudential solvency and liquidity requirements.

During the period under review assets of the insurance sector increased by FRW 71.1 billion (FRW 477.3 billion June 2019 to FRW 548.4 billion in June 2020), up against FRW 54.3 billion increase registered in the corresponding period of last year. Improved growth of assets was mainly underpinned by retained earnings (FRW 47.2 billion) and capital injections (FRW 3.1 billion). The retained profits increased in H1 2020 in line with the NBR policy that restricted dividend distribution for profits generated in 2019. The NBR decision aimed to support the solvency position of the sector amidst the COVID-19 induced financial stress. All the major components of Insurers' assets increased as follows: Placements in Banks (+ FRW 42.2 billion), government securities (+ FRW 10.9 billion), equities (+FRW 10.4 billion), properties (+3.4 billion), receivables (+FRW 2 billion), other assets (+2.1 billion).

Assets of the insurance sector

FRW 71.1bn

IN JUNE 2020

Placements in Banks continued to be the main investment avenue of the Insurers with around 42 percent of total Insurers' assets as at June 2020, followed by Government securities (19 percent) equity investments (12 percent), properties (9 percent), receivables (11 percent) and other assets (7 percent). The investments distribution varies with the class of business (Life or non-life insurance business). Life Insurers, with long- term liabilities, continue to invest in assets with long-term maturities to meet their long-term liabilities. For instance, Life Insurers' total long term Investments (government securities and properties) represented around 64 percent of total assets as at end June 2020. On the other hand, non-life Insurers (short term Insurers) held most of their assets in short term maturities, to cater for their short term liabilities– placements in Banks with average one year maturity represented 44.2 percent of total assets , government securities—majority treasury bills (16 percent).

As at end June 2020, life Insurers reduced the share of their investments in properties from 27 percent in June 2019 to 22 percent in June 2020. This is a positive developments given risks related to falling property prices and fall in commercial property occupancy rated due to COVID-19 economic downturn. Life insurers reduced their exposure in properties in favor of less risky investments like Government securities and placements— the size (percentage share) of life insurers' investment in Government securities (largely treasury bonds) increased from 41 percent in June 2019 to 48 percent in June 2020, while the stock of placements in Banks increased from 18 percent to 20 percent during the same period. For non-life Insurance, Insurers increased their investment in placements in Banks from 41 percent in June 2019 to 44 percent of their total assets as at June 2020, government securities (from 17 percent to 16 percent), Investment in properties (from 8 percent to 7 percent), while equity investments stabilized at 13 percent during the period.

While the impact of COVID 19 pandemic was not observable on assets of the insurers, premiums collection was to some extent affected. The growth of Insurers' premiums decelerated to 7.2 percent (y-o-y) in June 2020, down from 14.4 percent registered last year. This moderated growth of premiums mainly emanated from public medical Insurers reflecting the unremitted premiums (FRW 19 billion) observed in second quarter of 2020, compared to the unremitted premiums (FRW 17 billion) in same period of last year. Growth of premiums of public medical Insurers was FRW 1.9 billion (from FRW 32.6 billion in June 2019 to FRW 34.5 billion in June 2020), much lower than FRW than 6 billion in June 2019. On the other hand, the growth of premiums in private Insurers (life and non-life) was 3.3 billion (from FRW 41 billion in June 2019 to 44.3 billion in June 2020), the same growth registered in June 2019. For Private Insurers (life and non-life), unchanging growth of premiums was attributed to the increased restructured, suspended and cancelled policies. In line with NBR's request to insurers to support policy holders, restructured policies increased from FRW 1.7 billion in June 2019 to FRW 3.9 billion in June 2020, suspended policies (from FRW 34 Million to FRW 407 Million), and cancelled policies (from FRW 319 Million to FRW 724 Million).

The growth of Insurers' premiums decelerated

7.2% IN JUNE 2020

14.4% IN 2019

Net profits of Insurers (private and public) reduced

FRW21.1bn IN JUNE 2020

FRW23.2bn IN 2019

On consolidated basis, net profits of Insurance sector decreased in first half of 2020 mainly due to reduced underwriting returns and reduced growth of investment income. Net profits of Insurers (private and public) reduced from FRW 23.2 billion in June 2019 to FRW 21.1 billion in June 2020. Net profits of Insurance sector was largely weighed down by decline of profits in public Insurers (from FRW 18.5 billion in June 2019 to FRW 15.1 billion in June 2020), while profits of private Insurers increased from FRW 4.7 billion to FRW 6 billion.

The underwriting returns (core business of insurers) of public Insurers reduced from FRW 11 billion in June 2019 to FRW 8 billion in June 2020, reflecting the impact of COVID-19 pandemic that weakened much the growth of premiums, despite growth of claims and expenses moderating (Table 8). The underwriting returns of private Insurers improved over the last 4 years – i.e. from loss of FRW 4.2 billion in June 2017; to FRW 3 billion in June 2018; to FRW 1 billion in June 2019; to a loss of 0.5 billion in June 2020. The steady reduction of underwriting losses in private insurers reflects the impact of revised motor premiums that led to improved motor insurance premiums and effective claims management among private Insurers.

Profits of the insurance sector was also weighed down by the reduction of investment income, arising from the unfavorable economic conditions in H1 of 2020. For public Insurers, investment income reduced from FRW 7.4 billion in H1 2019 to FRW 6.4 billion in H1 202, mainly linked to reduced dividends from their equity investments. For Private Insurers, the investment income increased at lesser pace, by FRW 500 million (from FRW 5.3 H1 2019 to FRW 5.9 billion in H1 2020), lower than FRW 1 billion growth registered in June 2019.

Table 8: Key performance highlights of the insurance sector

Description (In FRW billion)	Private Insurers			Public Insurers			Insurance sector		
	Jun-18	Jun-19	Jun-20	Jun-18	Jun-19	Jun-20	Jun-18	Jun-19	Jun-20
Gross written premiums	37.7	41	44.3	26.6	32.6	34.6	64.3	73.6	78.9
Net written premiums	31.3	33.7	35.1	26.6	32.6	34.6	57.9	66.3	69.6
Total Claims	18.5	20.6	20.8	16	16.8	19	34.4	37.4	39.8
Management expenses	13.5	13.6	13.1	2.8	4.8	7.5	16.2	18.4	20.6
Net underwriting returns	-3	-0.9	-0.4	7.9	11	8	4.9	10.2	7.6
Investment Income	4.4	5.3	5.9	10	7.4	6.7	14.4	12.7	12.6
Other Income	1.7	1.9	2.1	0.2	0.1	0.3	1.9	2	2.4
Net profit after taxes	2.7	4.7	6	18.1	18.5	15.1	20.8	23.2	21.1
Assets	157.5	174.5	201.4	265.5	302.9	347	423	477.3	548.4
Technical provisions	84.4	95.9	104.8	1.1	1.3	1.4	85.5	97.2	106.3
Liabilities	21.5	23.9	31.2	4.7	2.3	5.9	26.2	26.2	37
Capital and reserves	51.6	55.5	65.4	259.7	299.2	339.7	311.3	354.8	405.1

Source: NBR, Financial Stability Directorate

FINANCIAL SOUNDNESS OF THE INSURANCE SECTOR

Insurers continued to meet the minimum regulatory capital requirements and remained solvent during the period under review. As at end June 2020, Private insurers' aggregate solvency ratio stood at 156 percent, compared to 100 percent minimum requirement. This solvency position reflects sufficient capital buffers to support growth of insurance businesses as well as withstanding adverse shocks like current COVID-19 pandemic. Public Insurers have for a long-time maintained significantly high solvency position- it stood at 2,463 percent as at end June 2020. High solvency position in public Insurers reflects the stable and profitable business of public Insurers over long period, while private Insurers' solvency level continued to be supported by capital injections and some growing profits during the period. During the period, paid up capital of private Insurers increased by FRW 3.1 billion (from FRW 53.8 billion in June 2019 to FRW 56.9 billion in June 2020), while retained profits (private and public) grew from FRW 44.1 billion to FRW 47.2 billion.

Private Insurers liquidity buffers remained satisfactory to cover short-term liabilities. The liquidity ratio that indicates the proportion of Insurers' liquid assets enough to cover their liabilities, increased from 124 percent in June 2019 to 134 percent in June 2020, and above 120 percent of prudential requirements. For public medical Insurers, liquidity positions remained quite high, above minimum requirements (Table 9). A high liquidity ratio indicates that the Insurers have sufficient liquid assets and don't dependent on new premiums to cover existing liabilities.

Insurance sector liquidity risks to closely monitor going forward relate to premiums receivables in private Insurers that doubled from FRW 2.2 billion in June 2019 to FRW 4.5 billion. In line with the NBR's guidance to insurers to support policy holders, insurers provided flexibility on premium payment schedules. Nevertheless, the level of premium receivables in in private insurers relative to their assets remains small (2.2 percent as at end June 2020), indicating that liquidity risks related to this is still small. Nevertheless, the NBR will continue monitoring the growth of these receivables, as well as, their impact on the liquidity position of insurers, and take necessary measures where risks are increasing.

Table 9: Key Financial Soundness Indicators of the Insurance sector

FSI (%)	Prudential Benchmark	Private Insurers			Public Insurers			Insurance sector		
		Jun-18	Jun-19	Jun-20	Jun-18	Jun-19	Jun-20	Jun-18	Jun-19	Jun-20
Solvency margin	**Min 100%**	149	174	156	2,195	2,297	2,463	1091	1190	1228
Claims ratio	**(60% -70%)**	64	62	62	55	52	55	59	57	59
Expenses ratio	**Max 30%**	46	41	39	10	15	22	27	28	30
Combined ratio	**Max 90%**	110	103	101	65	66	77	86	85	89
ROE	**Min 16%**	10	17	18	17	12	9	16	13	10
ROA	**Min 4%**	3	5	6	17	12	9	12	10	8
Liquidity ratio	**Min.120%**	121	125	134	3,481	4058	4,400	353	323	322

Source: NBR, Financial Stability Directorate

10 Pension Sector

Pension Funds remain the largest institutional investors, providing long term financing to the financial sector (mainly in Banks). As at June 2020, Pension Funds invested FRW 279.9 billion in banking sector and its total assets account for 17.3 percent of total financial sector assets. The pension sector is dominated by the mandatory public pension fund— the Rwanda Social Security Board (RSSB) that mainly covers formal sector employees as well as administer the Long Term Savings Scheme (LTSS-Ejo Heza) established under Prime Minister's Order No. 58/03 du 04/04/2018 to cover informal sector employees. These Public Pension Fund represented over 95 percent of pension sector's assets during the period. Private pension schemes remained 12 and represent around 5 percent of total pension sector's assets.

Public Pension Funds are managed as Defined Benefits scheme (DB) scheme, which provides pension benefits to retirees that were formally employed in public and private sector, and other benefits related to occupational hazards. Pension benefits are determined according to pension legislations and based on the age of insured; the period of contribution and his/her amount of salaries received during tenure in employment. On other hand, private pension schemes — voluntary based schemes are managed as Defined contribution scheme (DC), which provides pension benefits based on the contributions collected and the performance of the investment of those contributions.

PERFORMANCE OF PUBLIC PENSION FUND

Assets of pension funds continued to grow, mainly supported by steady growth of members contributions during the period under review.

Assets of Pension Funds grew by FRW 104 billion (from FRW 836.8 billion in June 2019 to FRW 940.8 billion in June 2020), compared to the growth of FRW 87.6 billion registered in the same period of 2019. The growth of assets was mainly supported by the contributions that improved from FRW 93.5 billion in June 2019 to FRW 102.6 billion in June 2020, indicating the increased number of employees (from 567,792 to 586,572).

Investment income, the other source of pension sector funds, reduced from FRW 35.2 billion in June 2019 to FRW 27.1 billion in June 2020, mainly reflecting the decline of their placement income in banks (from 14.7 billion to 7.6 billion).

Income from government securities was the major component of total investment income to RSSB, accounting for 55.6 percent of total investment income, followed by placements in Banks (28 percent); rentals (7.7 percent);

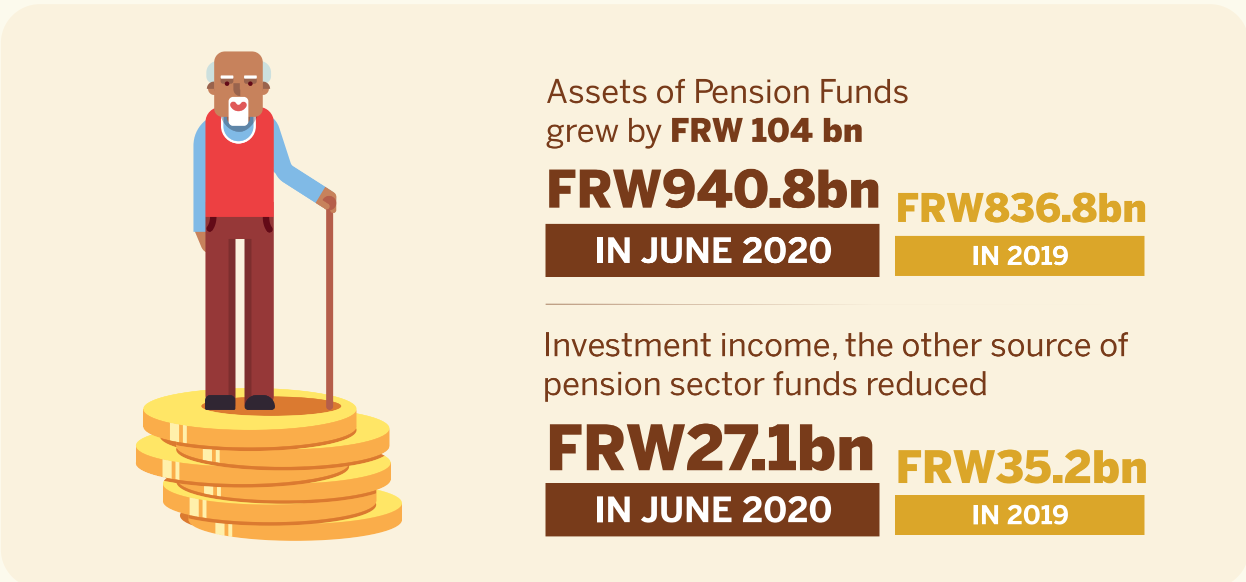


Table 10: Key financial highlights of Public Pension Fund

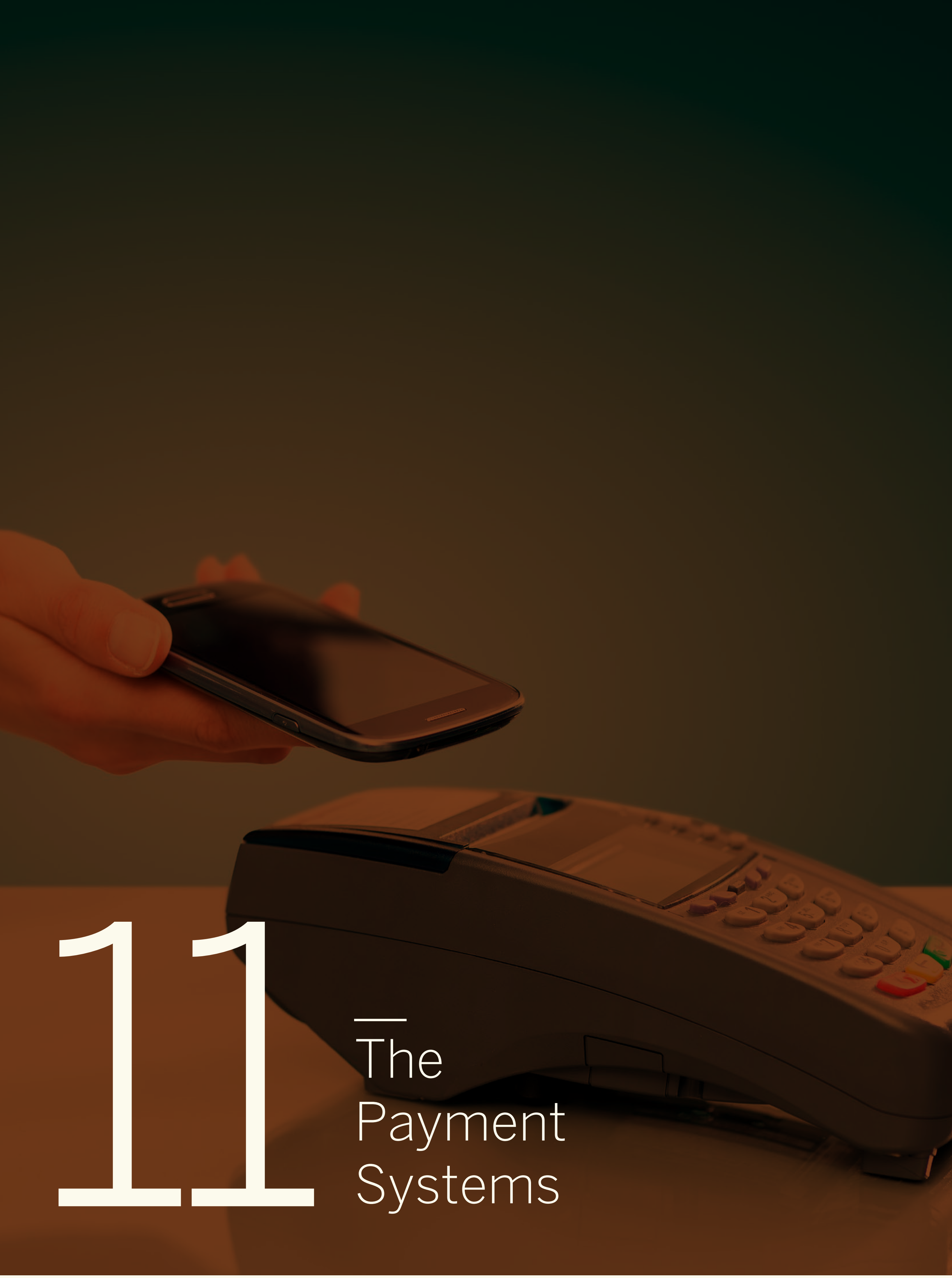
DESCRIPTION (in FRW Billion)	Jun-16	Jun-17	Jun-18	Jun-19	Jun-20	%change Jun-19/18	%change Jun-20/19
Total assets	584.2	661.3	749.2	836.8	940.8	11.7	12.4
Total contributions	74.5	77.5	89	93.5	102.6	5.1	9.7
Total benefits paid	15.8	17.7	21.1	26.9	29.9	27.5	11.3
Operating expenses	4.7	4.5	5.9	7.4	9.1	25.9	22.6
Investment income	23.1	27.4	29.3	35.2	27.1	20.3	-23.2

Source: NBR, Financial Stability Directorate

Table 11: Investment allocation of Public Pension Fund

Description (Billion FRW)	Jun-17	Jun-18	Jun-19	Jun-20	% Share	%Change Jun-19/18	%Change Jun-20/19
Government Securities	98.4	92.8	154.1	184.5	20	66.1	19.7
Equities	217.2	264.7	289.3	293.6	32	9.3	1.5
Investment in properties	117.5	98.4	117.1	138.1	15	19.0	17.9
Placements in Banks	187	199.7	154.9	174.1	19	- 22.4	12.4
Other investments and securities	39.3	78.9	102.9	128.3	14	30.4	24.7
TOTAL	659.4	734.5	818.3	918.5		11.4	12.2

Source: NBR, Financial Stability Directorate



11 The Payment Systems

The payment system landscape witnessed significant changes in line with the mobile phone penetration during the period under review. Due to the risks a payment system can pose to financial stability, the NBR's primary interest has been to ensure a secured and robust payment systems. Further, the NBR continued with its efforts to align its payment system with global developments. The key developments in the payments ecosystem for the period under review are highlighted in this sections that follow.

The key components of Rwanda Integrated Payment and Processing System (RIPPS) remained stable and facilitated smooth payment, clearing and settlement of financial transactions. The availability of the country's core financial infrastructure continued to be maintained at high level (99 percent) despite the growing number of financial transactions (Table 12). During the year to end June 2020, RIPPS processed 4,485,397 transactions worth FRW 14,396 billion from 4,240,663 transactions worth FRW 10,519 billion as at end June 2019, representing an increase of 5.8 percent in volume and 36.8 percent in value.

Table 12: RIPPS Transactions

Type of Transaction	Volume			Value (FRW Billion)		
	Jun-19	Jun-20	% Change	Jun-19	Jun-20	% Change
Single transfers	561,039	808,958	44.2	4,716.4	4,466.7	-5.3
Multiple transfers	3,405,444	3,399,042	-0.2	1,932.5	2,044.2	5.8
Interbank transfers	14,998	6,912	-53.9	3,012.4	6,931.7	130.1
Cheques	259,182	270,485	4.4	858.0	953.0	11.1
TOTAL	4,240,663	4,485,397	5.8	10,519	14,396	36.8

Source: NBR, Financial Stability Directorate

The payment infrastructures access points increased during the period under review (Table 13). The number of Point of Sale (POS) machines more than doubled to 41,891 as at end June 2020 from 20,484 as at end June 2019. Conversely, the volume of POSs transactions increased by 51.9 percent to 2,910,090 as at end June 2020 from 1,916,013 as at end June 2020. Similarly, the value of POSs transactions increased by 10.8 percent to FRW 106.7 billion as at end June 2020 from FRW billion 96.3 as at end June 2020. Regarding, the automated teller machine (ATMs), ATM transactions increased by 11 percent to FRW 558 billion. As an essential service, ATMs operations continued as normal and banks maintained the ATM market uptime to 92. 5 percent.

Table 13: Development of Payment Access Points

Payment Access Points	Jun-17	Jun-18	Jun-19	Jun-20
Number of ATMs	405	382	390	331
Traditional POS terminals	2,031	2,198	3,046	3,731
New Types of POS	-	12,959	17,048	37,829

RIPPS transactions processed

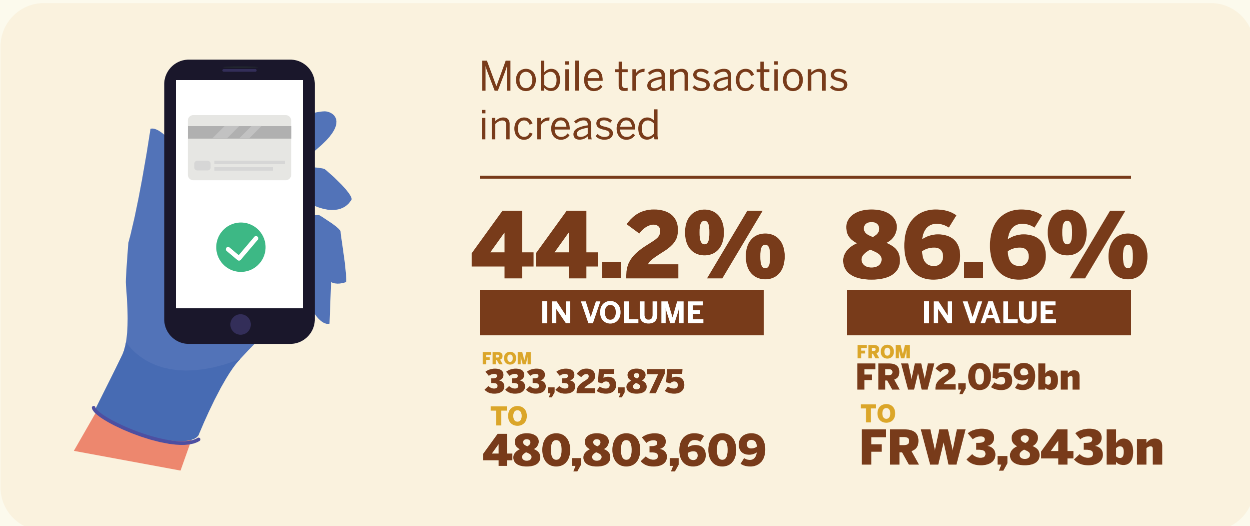
4,485,397
worth **FRW14,396bn**
IN 2020

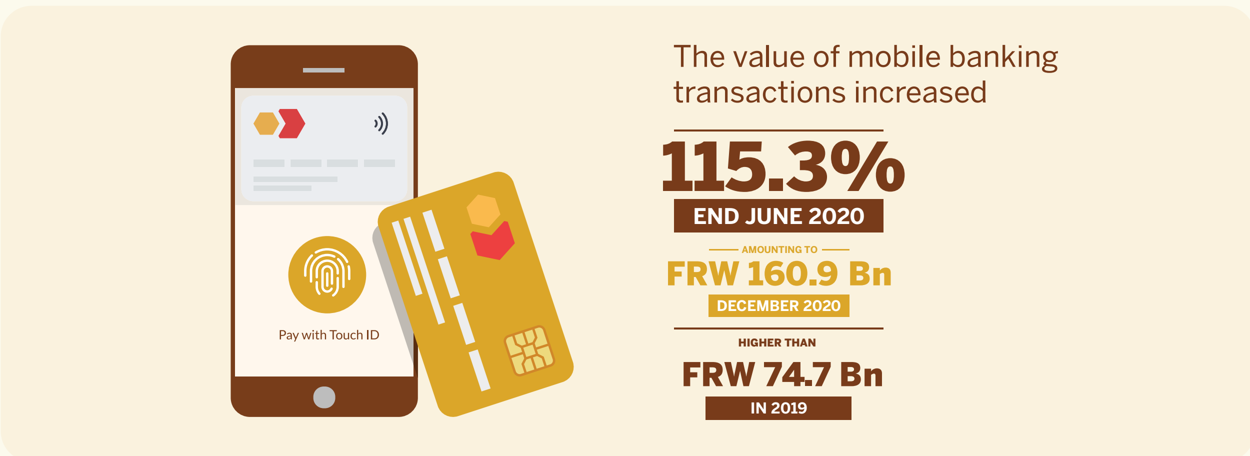
4,240,663
worth **FRW10,519bn**
IN 2019

The payment industry supported the response to COVID-19. Banks and telecommunication companies have offered reliefs through the reduction of payment fees and charges on some of the products and services offered to customers. The stakeholders in payment industry provided reliefs to clients for the period of three months by agreeing to: i) Zero charges on all transactions between bank accounts and mobile wallets (push and pull), ii) Zero charges on all mobile transfers, iii) Zero merchant fees on payments for all contactless point of sale (mobile and virtual POS) transactions and iv) Increasing the limit for individual transfers using mobile money wallets from FRW 500,000 to FRW 1,500,000 for Tier 1 customers and from FRW 1,000,000 to FRW 4,000,000 for Tier 2 customers.

In parallel with incentives provided to customers, the retail payments picked up significantly and the uptick was more apparent during the lockdown. During the period under review, mobile financial services (mobile payments and mobile banking) accelerated on account of increased penetration of mobile technology and recent cashless payment awareness campaigns conducted by the NBR. On one hand, the volume of mobile payments increased by 44.2 percent from 333,325,875 to 480,803,609, while in value, mobile payments increased by 86.6 percent from FRW 2,059 billion to FRW 3,843 billion. The number of mobile payments agents increased to 111,422 as at end June 2020 from 102,181 as at end June 2019. On the other hand, the volume of mobile banking transaction increased by 73.7 percent to 4,897,019 as at end June 2020 from 2,820,040 as at end June 2019. Similarly, the value of mobile banking transactions increased by 115.3 percent to FRW 160.9 billion as at end June 2020 from 74.7 billion as at end June 2019.

With regards to internet banking, the number of subscribers increased to 84,908 as at end June 2020 from 79,079 as at June 2019. Subsequently, the volume of internet banking transactions increased by 70.4 percent to 1,864,838 in June 2020 from 1,094,144 in June 2019. During the same period, the value of internet banking transactions increased by 48.8 percent to FRW 3,024 billion from FRW 2,032 billion.





12 Policy Reforms Implemented

The National Bank of Rwanda is determined to establish a robust legal and regulatory framework necessary for a stable and developed financial system. Over the last 6 months, the NBR issued 3 Regulations, 4 Directives and 2 Guidelines. These legal instruments aim to support financial stability, and provide basis for financial innovation and product development, as well as the promotion of financial integrity. Details of the Regulations and Directives approved since the last MPFSS are explained in paragraphs below.

Regulation on Mortgage Refinance Companies

The NBR established Regulation N° 33/2020 OF 08/06/2020 governing the licensing and operation of mortgage refinance companies. The regulation is a step towards the Government of Rwanda's goal of increasing decent and affordable housing to its citizens. Mortgage refinance companies are expected to support the housing market by providing long-term financing to mortgage lenders (Banks and microfinance institutions); offering secondary market for mortgage lenders and lowering the cost of mortgage loans for borrowers. This regulation lays foundation for regulating mortgage refinance companies. It stipulates the licensing conditions; the governance and risk management standards; the prudential requirements; as well as, permissible & non-permissible activities for mortgage refinance companies.

Regulation Determining Administrative Sanctions for non-compliance with AML/CFT requirements

In June 2020, the NBR established a regulation determining administrative sanctions and fines for non-compliance with Ant-Money Laundering and Combating of the Financing of Terrorism (AML/CFT) requirements. This regulation comes to implement law Nº 75/2019 OF 29/01/2020 on prevention and punishment of money laundering, financing terrorism and proliferation of weapons of mass destruction. This regulation comes also to support the NBR to implement the recommendations of Financial Action Task Force (FATF) by sanctioning and fining financial institutions non-complaint with AML/CFT requirements. This regulation spells out conditions for imposition of the administrative sanctions; circumstances to determine sanctions to impose; types of administrative sanctions on Financial Institutions (FIs); nature of sanctions against FIs Management; disclosure of violations requirements by the Board of Directors and senior management of financial institutions; nature of sanctions against senior management of financial institutions and; the recovery process of the administrative fines.

Regulation governing change in Shareholding, Amalgamation and Transfer of Portfolio of Insurers and Re-Insurers

In June 2020, through regulation No 34/2020 of 08/06/2020, the NBR revised the regulation governing the change of shareholding, amalgamation and transfer of portfolio of insurers and reinsurers. This new regulation will support the orderly transfer of insurance business (shareholding, portfolio transfer, amalgamation and demutualization). It replaces regulation No 14/2011 on mergers and acquisition of insurance companies. By reviewing this regulation, NBR addressed gaps identified in the previous regulation and aligned to the International Association of Insurance Supervisors (IAIS) Core Principle (ICP) - particularly ICP6 on changes in control and portfolio Transfers. The regulation sets limits on shareholding; stipulates regulators pre- approval assessment factors; details other specific requirements on the transfer of significant holding and controlling interests; instigates a requirement for public notice on any amalgamation between insurers and; stipulates the approval process, as well as, the pre and post approval requirements of any amalgamation and transfer of portfolio of insurers and reinsurers.

Directive operationalizing the Extended Lending Facility to Banks (ELFB)

In April 2020, through Directive No. 0025 of 9/4/202, NBR established an Extended Lending Facility for Banks (ELFB) worth FRW 50 billion to support banks facing liquidity shortfalls due to COVID-19 outbreak. This fund was designed to run for six months (April- October 2020) and for a bank to access this fund, it should demonstrate that it's facing transitory liquidity distress; that it's adequately capitalized as per NBR norms; and should have eligible collaterals acceptable by the central banks. The other provisions of this directive (ELFB) relate to tenure of this funding; application process; borrowing limits and collateral valuation; applicable interest rate; repayment obligation and; other requirements or restrictions for a beneficiary bank.

Directive on Economic Recovery Fund (ERF)

Following the Cabinet resolution of 30/04/2020 to establish the Economic Recovery Fund (ERF) to support businesses severely affected by COVID-19, NBR, designated as fund manager, established Directive No 0300/2020-00015[613] specifying the structure of the fund; the conditions for financial institutions to access this fund; eligibility requirements for borrowing firms, and; the operational process of the fund. The ERF managed by NBR is structured in four financing windows to support firms severely affected by COVID-19. These include: (1) the hotel financing window; (2) the working capital window for large corporates; (3) working capital for SMEs and; (4) working capital for micro-businesses. Lending under the first three windows is through banks, while the fourth one is through LTD MFIs and UMWALIMU-SACCO. Further to these NBR managed windows, the ERF has another financing window managed by BDF for micro-businesses that bank with SACCOs; and an SME guarantee scheme (to de-risk SME lending during current economic uncertainties caused by COVID-19.

Directive Determining the Characteristics of an Independent Director of a Financial Institution

The NBR established the directive n° 2600/2020 – 0017 [613] of 22/06/2020 determining the characteristics of an independent director of a financial institution. This directive sets characteristics of an independent director of a financial Institution. According to this directive, an independent director of a financial institution is one who fulfills the following four conditions: i) has no management relationship with the financial institution and its related parties, ii) has no business relationship with the financial institution or its related parties, iii)) Is not connected to a significant shareholder and iv) Does not represent interests of any shareholder of a financial institution or its related companies. Further, the directive bestows the responsibility for assessing the criteria of an independent director to the Board Nomination and Remuneration Committee. For a financial institution without a Nomination and Remuneration Committee, the Board shall be responsible for the assessment.

Directive on underwriting requirements of large risks

In July 2020, NBR issued the Directive No 4230 of 15 /07/2020 governing the underwriting of large risks. This directive sets guidance on the underwriting of large risks in order to ensure that local Insurers exhaust local capacity through co-insurance arrangements; avoid unfair competition; and ensure the growth and development of the insurance market. The directive prohibits the fronting practices and stipulates the requirements of co-insurance arrangements and its claims settlement; responsibilities of the lead insurer in co-insurance arrangements; requirements on externalization of large risk to foreign re-insurers and Insurers. The directive further requires the establishment of large risk committee, specifying the members of the committee and its responsibilities.

Guideline to Banks on treatment of IFRS9 provisions, capital requirement and relief measures due to COVID-19 pandemic

As a follow-up to the NBR's request to banks to prudently restructure loans of businesses affected by the COVID-19 outbreak, the central bank issued a guideline to banks on the regulatory and accounting treatment of restructured loans due COVID-19. The guideline provides clarity or NBRs expectation on the responsibility and Governance of the loan restructuring processes; the IFSR9 estimation of Expected Credit Losses (ECL) and Significant Increase in Credit Risk (SICR) for restructured loans due to COVID-19 outbreak; classification of restructured loans due to COVID-19; treatment of regulatory capital for restructured loan facilities and treatment of write-offs for loans in class 5. Paragraphs below summarize key provisions on this guideline.

On loan classification, NBR stressed that restructured loans due to COVID-19 shouldn't automatically be classified as non-performing loans as per the directive on treatment of credit risk. Instead, banks are required to base their judgement on other factors that indicate the unlikeness to pay, taking into consideration the cause of the financial difficultly and whether it's short-term or long-term. NBR also provides that the payment moratorium period due the COVID-19 outbreak can be excluded from the number of past due or generate arrears as the directive on treatment of credit risk.

On IFRS9 implementation, given the high uncertainties of the forward looking information important for estimating the expected credit losses (ECL) and the determination of changes in Significant increases in Credit Risk (SICR) during the current COVID-19 outbreak, NBR provided guidance to banks on key considerations they should consider while calibrating their models. First, banks were advised to allow flexibility in their models to capture economic relief measures implemented by the Government and NBR to support economic resumption- in otherward models shouldn't be biased on the negative deterioration in credit risk and current economic conditions, also consider the economic stimulus measures implemented by the Government and NBR. Second, banks shouldn't consider the current economic downturn as permanent, but temporary and the lifetime probability of default of restructured loans due to COVID-19 shouldn't be based on current conditions, but long-term economic conditions.

Banks were also allowed to extend by 365 days the write-off date of credit facilities classified in loss category (class 5), provided that the write-off period fall due within the period of this guideline (i.e., end June 2021). Normally banks are supposed to write-off a loan facility after 365 days in the loss category. This flexibility is based on the fact that in context of prevailing economic condition and property prices, banks can't recover reasonable funds from foreclosing collaterals.

Guideline for Loan restructuring for MFIs/SACCOs

In the spirit of supporting clients of microfinance institutions who were also affected by the COVID-19 outbreak, In June 2020, NBR issued a guideline to MFIs and SACCOs, requesting them to prudently restructure loans of their customers negatively affected by the COVID-19 outbreak. The guideline issued by NBR specifies the eligibility criteria for this restructuring— borrowers who can demonstrate that their financed projects were negatively affected the COVID-19 outbreak. The other key provisions of this guideline include: the payment moratorium period of 4 months (i.e., from March to June 2020); stresses that interest rate on restructured loans will continue to accrue during the moratorium period and will be capitalized; urges MFIs and SACCOs to ensure that the new repayment amount after restructuring is comparable to what customers paid before restructuring; provides that loans restructured due to COVID-19 will maintain the same class and provisions held before the pandemic(end February 2020); and stresses that no restructuring fees and penalties shall be charged to borrowers.

The financial sector is projected to remain sound and stable in the near-future, despite the stress caused by the COVID-19.

This projection is based on the current capital and liquidity buffers held by the financial sector and gradual economic recovery observed since the third quarter of 2020. The NBR is prepared with a set of tool liquidity tools and other supervisory plans to support any stressed institutions. The objective of NBR during current uncertain times is to encourage effective risk management in supervised institutions, as well as enforce operational resilience against pandemic scenarios.

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