NATIONAL BANK OF RWANDA
BANKI NKURU Y'U RWANDA

ANNUAL FINANCIAL STABILITY REPORT

JULY 2020 - JUNE 2021

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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.

Foreword

As part of its key mandate of ensuring a stable financial system, the National Bank of Rwanda (NBR) as an integrated supervisory and monetary authority regularly assess and closely monitors developments in all areas relevant to financial stability as well as the capacity of the financial sector to withstand various shocks. The financial sector stability assessment aims at analyzing the underlying risks to the financial sector with the ultimate objective of implementing the necessary mitigation policies. In view of this, the NBR's current financial sector risks assessment are underlined in this report.

This edition of annual Financial Stability Report (FSR) is released at the time macro financial conditions continue to be conditioned by the COVID-19 pandemic and related containment measures. So far, the impact of the pandemic on the financial sector has broadly been the increased credit risk. The COVID-19 induced economic contraction between March 2020 and March 2021, which resulted in loss of income for both households and corporates and adversely affected debt serviceability in the most affected sectors including hotels and commercial real estate. With increased credit outlook, banks increased their provisions and are expected to play a safeguard role in absorbing emerging credit losses.

Notwithstanding increased credit risk, the financial sector remains resilient to the pandemic shock. Since the publication of the previous edition in October 2020, the regulated financial institutions continue to cope relatively well with the challenges posed the effects of the pandemic on the economy and economic agents that deal with them. Overall, the financial sector remains adequately capitalized, liquid and the regulated financial institutions managed to continue playing their role without any major interruptions. In payment landscape, the payment systems continued to operate smoothly with all systemically important payment systems operating without any significant disruptions.

Going forward, the financial sector is expected to remain stable. The regulated financial institutions hold ample capital and liquidity buffers that are expected to be deployed to absorb the emerging shocks. The economic recovery is on course and is expected to further sustain the stability of the financial sector by way of improving debts service, assets quality and overall soundness of the financial sector.

RWANGOMBWA John
Governor

"The financial sector remains stable and resilient to the shocks induced by COVID-19, thanks to the regulatory, monetary and fiscal policies implemented to contain the impact of the pandemic. The notable economic recovery will continue to sustain the stability of the financial sector by way of improving debts serviceability, assets quality and overall soundness of the financial sector."

Acronyms

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

1 Global Macro-Financial Development

The global economic recovery from the COVID-19 pandemic is on course supported by wide vaccination and substantial policy support measures, particularly in advanced economies. According to the International Monetary Fund (IMF) World Economic Outlook report of July 2021, the global economy is expected to recover from a contraction of 3.2 percent in 2020 and grow by 6.0 percent in 2021 and 4.9 percent in 2022 (Table 1). This growth prospects reflect easing of the pandemic-related restrictions and policy support measures.

The recovery is on a more solid footing in advanced economies reflecting elevated vaccination rates and greater policy support. In developed economies, fiscal stimuli have been broadened, vaccination rollout has accelerated and containment measures are being lifted, leading to improved spending. This has led to improved economic growth expectations for 2021. The economic activities in advanced economies are expected to grow by 5.6 percent in 2021 after a contraction of 4.6 percent in 2020. The growth is particularly expected to be strong in United States (US), where substantial fiscal stimulus was implemented in the first half of 2021, the economy is more advanced in its reopening phase and the labor market is recovering. The US economy is expected to grow by 7 percent in 2021 from a decline of 3.5 percent in 2020.

In Emerging Markets and Developing Economies (EMDEs), the spread of new variants remains a risk, but the recovery is expected in the second half of the year as case numbers fall and restrictions are eased. The emergence of new variants of the COVID-19 virus coupled with the slower vaccination deployment in many emerging-market economies impeded the growth in the first half of 2021. India, Brazil and South Africa registered record-high new cases of infections, which impacted significantly on their growth prospects. The aggregate economy for EMDEs is expected to recover in the second half of 2021 and grow by 6.3 percent in 2021 and 5.2 percent in 2020 from a decline of 2.1 percent in 2020. This improvement largely reflects China's expected rebound. In China, economic recovery continues to benefit from the country's high participation in global value chains as demand for pharmaceuticals, medical supplies and communication equipment accelerates. Growth of the Chinese economy is expected to improve to 8.1 percent in 2021 and 5.7 percent in 2022, from 2.3 percent in 2020.

For Sub-Saharan Africa (SSA), the economy is recovering at a slower pace compared to advanced countries and EMDEs, reflecting slow vaccination in the region and limited policy support measures. The economic activities in SSA contacted by 1.8 percent in 2020 as a result of the COVID-19 pandemic. This was the region's first deepest recession since the 1960s. The recession was however lower than initially projected, as the virus spread more slowly than anticipated and agricultural activities remained strong in some countries. The positive spillovers from strengthening global activity including higher commodity prices, better international control of COVID-19, and strong domestic activity in agricultural commodity exporters are expected to gradually lift the growth. The real output in SSA is expected to expand by 3.4 percent in 2021 and 4.1 percent in 2022. The recovery could however remain fragile given the slow pace of vaccinations in the region.

The global outlook, however, remains subject to downside risks, including the emergence of new virus variants, divergent recovery paths across countries and a sharp tightening of global financial conditions. The expectations for economic recovery remain uncertain and will further depend on the course of the pandemic. In large parts of the world, the vaccination programmes are getting under way only slowly, and in some cases access to vaccines is limited. The global economy will not stage a lasting recovery until the virus is under control worldwide. The potential emergence of vaccine-resistant virus poses a risk to all countries, and as long as the Virus remains, the economic impact may continue to persist.

Global economy is projected to recover by

6.0%
in 2021

AND

4.9%
in 2022

After contracting by

3.2%
in 2020

Table 1: The Global Growth and Projections.

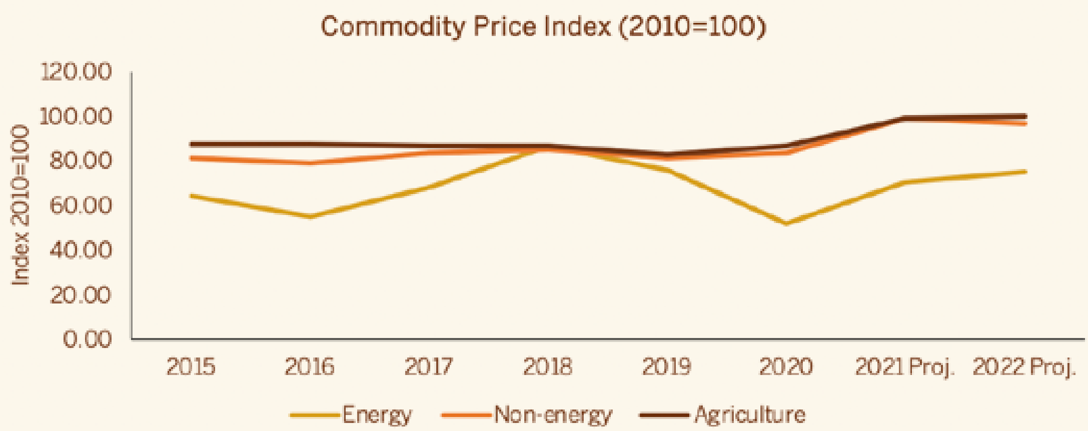
Growth Projections by Region	2018	2019	2020	2021 Proj.	2022 Proj.
World	**3.6**	**2.8**	**-3.2**	**6.0**	**4.9**
Advanced Economies	**2.2**	**1. 6**	**-4.6**	**5.6**	**4.4**
United States	2.9	2.2	-3.5	7.0	4.9
Euro Area	1.9	1.3	-6.5	4.6	4.3
Japan	0.3	0.7	-4.7	2.8	3.0
United Kingdom	1.3	1.4	-9.8	7.0	4.8
Emerging Markets & Developing Economies	**4.5**	**3.7**	**-2.1**	**6.3**	**5.2**
Russia	2.5	2.0	-3.0	4.4	3.1
Brazil	1.3	1.4	-4.1	5.3	1.9
China	6.7	6.0	2.3	8.1	5.7
India	6.1	4.0	-7.3	9.5	8.5
Sub-Saharan Africa	**3.2**	**3.2**	**-1.8**	**3.4**	**4.1**
Nigeria	1.9	2.2	-1.8	2.5	2.6
South Africa	0.8	0.2	-7.0	4.0	2.2

Source: IMF, WEO, July 2021.

The rebound of the commodity prices is also contributing to current economic momentum. The commodity prices have sharply recovered since the third quarter of 2020 in line with global recovery and China demand for commodities that continued to support the global trade. Oil prices have rebounded trading above USD 65/barrel for the first time since May 2019 and averaging USD 63.2 /barrel in H1 2021 higher than USD 38.7/ barrel in H1 2020. Non-energy commodity price index rose by 36 percent in H1 2021, following a contraction of 3.4 in H1 2020, supported by continued strong demand from China as well as recovery in demand in the rest of the world. The agricultural commodity price index increased by 26 percent in H1 2021 against 1. percent growth in H1 2020 driven by the strong global demand.

The outlook for commodity prices is positive in line with projected global recovery. According to the World Bank commodity market outlook, oil prices in 2021 are projected to be on average USD 56/barrel in 2021 higher than USD 41.2/barrel in 2020, and see a further increase to USD 60/barrel in 2022 as demand continues to gradually rise. Metal prices are expected to average 30 percent higher in 2021 than in 2020 on the back of strong demand. Agriculture commodity prices are forecasted to average nearly 14 percent higher in 2021 and stabilize thereafter. These prospects will continue to be beneficial for commodity exporting countries that rely on commodity export receipts to finance the imports and ease the exchange rate pressures.

Figure 1: The Annual Commodity Prices



Source: World Bank Commodity Market Database, September 2021.

The extraordinary policy responses are effectively supporting the economic recovery and cushioning pandemic related risks to the global financial system. Central banks globally responded quickly to the global economic shock from COVID-19 by reducing policy interest rates, providing direct liquidity support, purchasing government bonds and granting regulatory forbearances. These policies complemented the significant economic stimulus provided by fiscal authorities and have so far have been key in supporting the recovery process and containing risks to the global financial sector. After more than one year into the pandemic, banks globally remain resilient to the pandemic with adequate capitalization and have so far continued to fulfil their role, maintaining levels of lending to firms and households. The resilience of the financial sector is mainly reflective of substantial monetary and fiscal support together with regulatory forbearance policies as previously explained. Moreover, buffers held by banks at the onset of the pandemic and dividend restrictions have allowed banks to build their capital and played a part in absorbing the global shock.

However, the accommodative global financial conditions while necessary to cushion the economic impact of the pandemic shock have been accompanied by increased risk-taking in financial markets. The central bank actions contributed to record-low interest rates that led investors to seek out better returns. This search-for-yield behavior and generally low interest rates have contributed to higher asset prices. Equity prices of the world's major stock exchanges have increased considerably and pose vulnerability to a sharp correction in asset valuations going forward. As the global recovery strengthens, policy normalization could result in increase in interest rates and later on the cause the abrupt adjustments in asset prices.

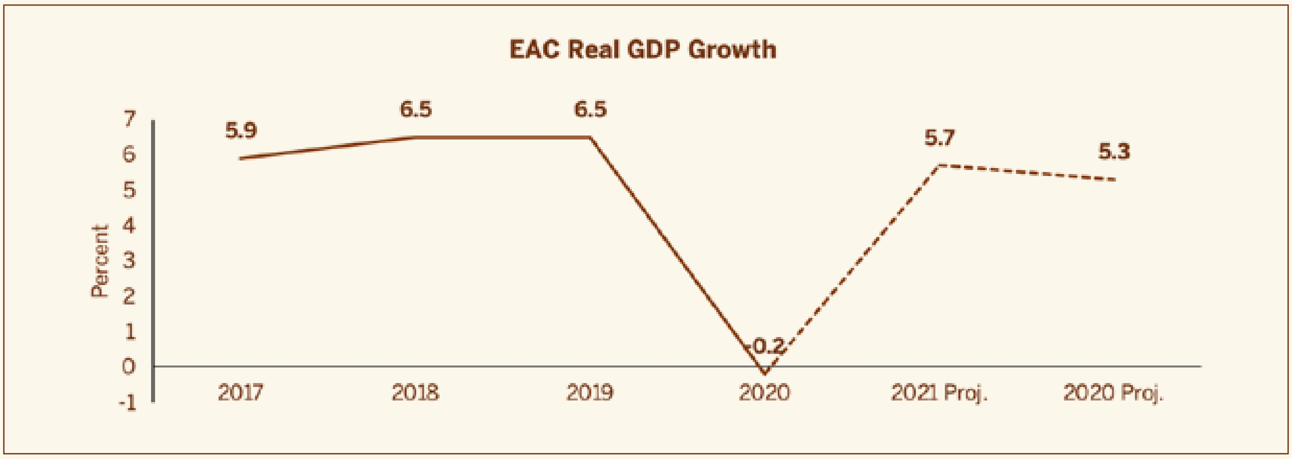
The global financial system is also vulnerable to higher levels of sovereign and corporate indebtedness. There has been an increase in corporate and government indebtedness following the outbreak of the pandemic. In many countries, private and public sector debts have reached record levels as accommodative monetary policy resulted in low debt servicing costs. Borrowing costs are currently low, making these debts somehow manageable. However, there is a risk that if interest rates increase swiftly from these low levels, debts will become more difficult to service and create risk for creditors.

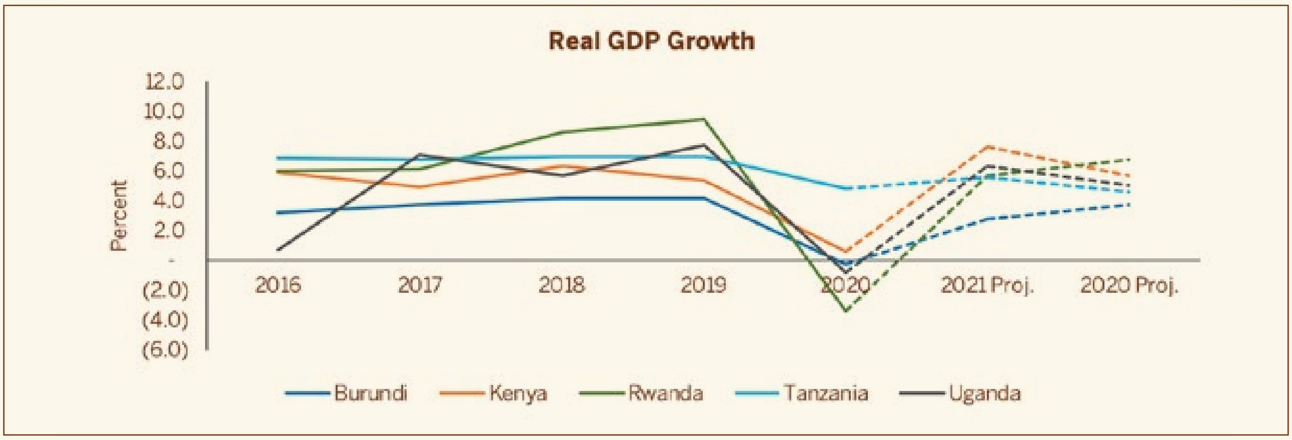
2 Regional Economic and Financial Sector Developments: East African Community (EAC)

The emergence of the pandemic has elevated macro financial risks in the EAC region. As in the rest of the world, economic performance in the EAC region during 2020 and 2021 has been entirely conditioned by COVID-19 pandemic. The services sector that drives the economies of EAC countries has been severely affected by the pandemic. The containment measures imposed to limit spread of the disease but in particular curfews and restrictions on international travel significantly affected tourism and hospitality related sectors, export receipts, exchange rate depreciation and increased risks in the financial sector. In 2020, real GDP contracted by 0.2 percent against the growth of 6.5 percent in 2019. At country level, real GDP in Rwanda contracted by 3.4 percent in 2020 against the growth of 9.5 percent in 2019. During the same period, real GDP contracted by 0.8 percent and 0.3 percent in Uganda and Burundi against the growth of 7.7 percent and 4.2 percent, respectively. In Kenya, the growth of real GDP moderated to 0.6 percent in 2020 from 5.4 percent in 2019, while in Tanzania, the growth of real GDP moderated to 4.8 percent in 2020 from 7 percent in 2019. In Tanzania, the moderation of the growth mainly reflects the negative impact of COVID-19 pandemic on some economic activities, particularly those related to hospitality and tourism. However, the impact was less severe compared to other countries due to measures taken by the Government to curb the negative effects of the pandemic on the economy, including the decision of not imposing a nationwide lockdown.

Economic activity is bouncing back in EAC countries, supported by policy measures, recovering commodity prices and easing of containment measures. Though the economic performance remains below the pre-pandemic level, the economic activities are recovering across EAC. During the first quarter of 2021, all EAC partner states registered positive growth. Real output grew by 6.2 percent in Uganda, 4.9 percent in Tanzania, 4.6 percent in Kenya, 3.6 percent in Rwanda and 2.8 percent in Burundi. The ongoing policy support measures and rollout of vaccines are expected to speed up the recovery for the remainder of 2021 and beyond contributing to further economic reopening and increased expenditure. The increase of foreign demand and commodity prices in line with improved global outlook are also key drivers of the recovery. The aggregate real GDP for EAC countries is expected to grow by 5.7 percent in 2021 and 5.3 percent in 2022. At country level, the economy is projected to grow by 7.6 percent in Kenya, 6.3 percent in Uganda, 5.7 in Rwanda, 5.6 percent in Tanzania and 2.8 percent in Burundi. This economic outlook in EAC region offers optimism in protecting the financial sector from increased risk. The assets quality will improve and with increased loan portfolio, profits of banks will follow.

Figure 2: Real GDP Growth and Projections in EAC

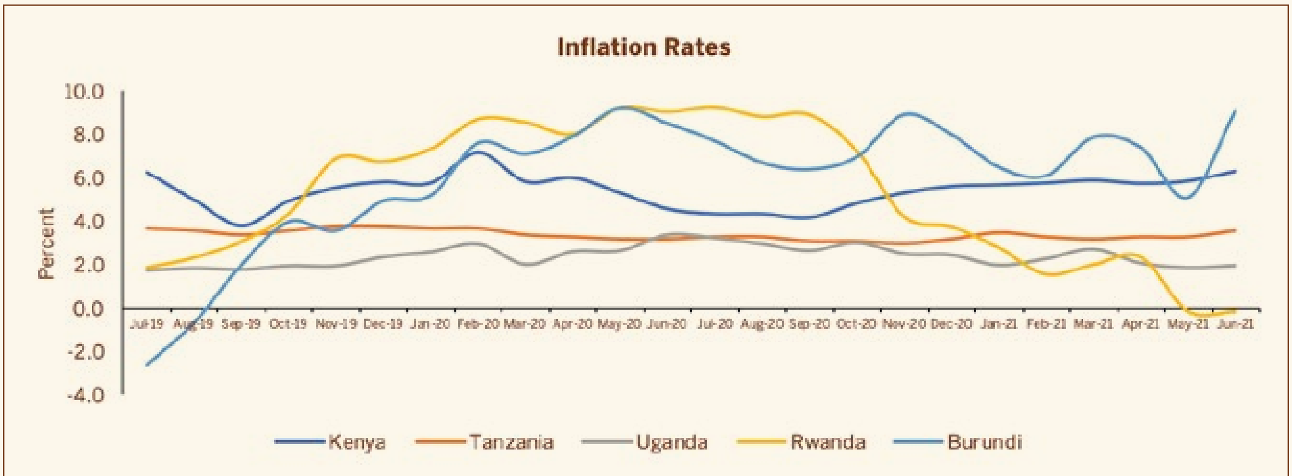


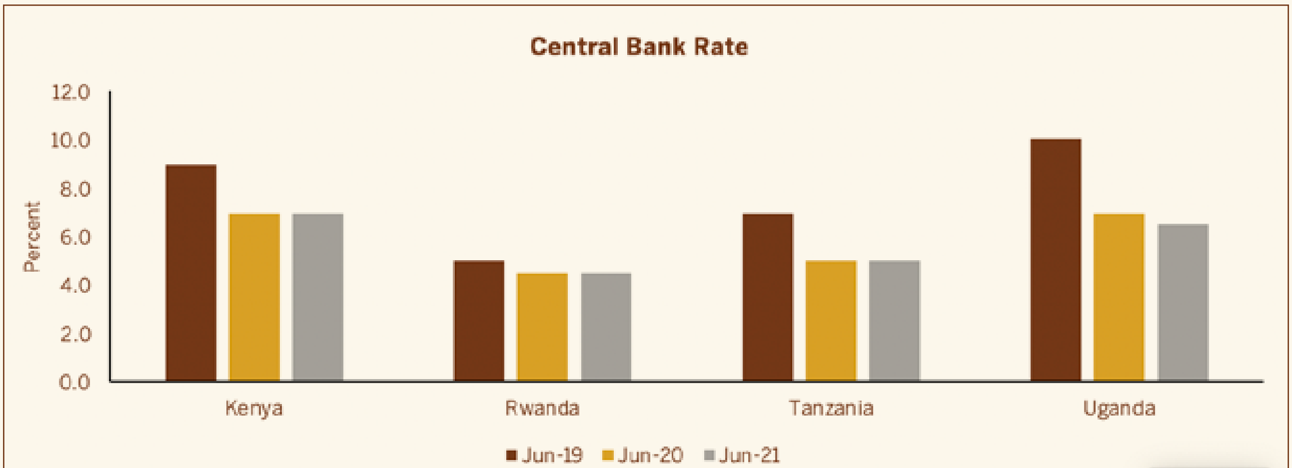


Central bank's monetary policy remains accommodative to support the economic recovery and cushion risks to the financial sector. Inflation in EAC remains below central banks targets, providing room for monetary policy accommodation. The annual average consumer price inflation stabilized at 4.5 percent during the year to end June 2021, the same level it was during the previous year. The stability of inflation mainly reflects weak demand during the period of the pandemic, good agriculture production and subdued oil prices, especially during the first half of 2020. The annual inflation rate in Kenya averaged 5.3 percent during the year to end June 2021 against 5.5 percent during the year to end June 2020. During the same period, the annual inflation in Tanzania averaged 3.3 percent against 3.5 percent, 2.5 percent against 2.3 percent in Uganda, 4.2 percent against 6.3 percent in Rwanda and 7.2 percent against 4.7 percent in Burundi. With improving demand, inflation is expected to increase in second half of 2021 but will remain below 8 percent convergence criterial in all partner states in 2021 and 2022 and central banks will continue to implement policy support measures whenever necessary.

The implemented policy measures have been mainly in form of reducing the central bank rates, reducing the statutory reserve requirements and providing direct liquidity support to solvent banks facing liquidity stress. For example, in Kenya, the cash reserve ratio was reduced to 4.25 percent from 5.25 percent since March 2020 and the central bank rate from 8.25 percent to 7.25 percent in March 2020 and remained unchanged at 7 percent since April 2020. In Tanzania, the statutory minimum reserve ratio was reduced to 6 percent from 7 percent since June 2020 and the discount rate from 7 percent to 5 percent since May 2020. In Uganda, the central bank rate was reduced from 9 percent to 8 percent in April 2020 and further to 7 percent and 6.5 percent in June 2020 and June 2021, respectively. In Rwanda, the NBR cut the reserve requirement to 4 percent from 5 and the central bank rate to 4.5 percent from 5 percent. These measures complimented COVID-19 liquidity assistance programs and fiscal policy measures that were instituted to ease the liquidity stress in the financial sector.

Figure 3: Inflation Rate and Central Bank Rate in EAC





The credit growth registered mixed results in EAC partner states mainly on account of perception of risks and credit demand. The outstanding credit in Burundi expanded by 23 percent in June 2021, higher than the growth of 22 percent in June 2020. During the same period, outstanding credit grew by 18.6 percent higher than 14.6 percent in Rwanda and stabilised around 7.7 percent in Kenya. In Tanzania, the growth of outstanding credit moderated to 3.6 percent in June 2021 from 5.5 percent in June 2020, while in Uganda, the growth of outstanding credit moderated to 7 percent in 2021 from 13.2 percent in June 2020. The improved growth of credit in Burundi, Rwanda was mainly underpinned by the growth of new lending, while in Kenya, though credit growth was stable, it was limited by risk averseness of banks following the deterioration of assets quality. In Tanzania, the slowdown of lending mainly mirrors the increase of credit risks in banking sector, whereas in Uganda, the moderation of the growth of loans is mainly linked to weak credit demand and banks perception of risk that had an impact on new lending.

The financial sector remains resilient to the pandemic shock. Banks continue to hold capital and liquidity buffers above the regulatory requirement in all EAC partner states (Table 2). Banks entered the pandemic with relatively strong balance sheets, benefiting from the reforms that were recently implemented mainly embodied in Basel II/III standards. In the aftermath of 2007/2009 global financial crisis, the EAC central banks implemented capital adequacy framework that includes the minimum capital charges for market and operational risks on top of credit risk and maintain a spread of 4 percent above the Basel II minimum standard requirements. Furthermore, the EAC central banks are at advanced stages of implementing Basel III liquidity measures including the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR). These reforms enabled banks to cushion the economic impact of the pandemic and supporting the recovery through new lending and measures such as loan repayment deferrals.

Additionally, the substantial policy support from governments and central banks also underpinned the resilience of the financial sector. The regulatory flexibility, liquidity enhancing programs and restrictions on payment of dividends have ensured that banks maintained sound liquidity and capital buffers. Central Banks of Rwanda, Kenya and Uganda imposed restrictions on payment of dividends to shareholders to enable banks enhance their capital buffers with retained earnings. With the ongoing recovery and promising global economic outlook, the financial sector is expected to remain stable and central banks have started to reverse some of the policy measures that were instituted to cushion the impact of the pandemic. For example, in Kenya, debt restructuring allowance that was instituted to extend credit payment deferrals to customers affected by the pandemic matured in March 2021. In Uganda and Rwanda, credit restructuring allowance expired by end September 2021. The withdrawal of the COVID-19 measures is based on assessment of individual country context and is generally meant to maintain integrity and confidence in the financial system and to address moral hazard related risks (Box 1).

Credit risk has increased and remains the major threat to the financial sector. Non-Performing Loans (NPL) ratio in Kenya increased to 14 percent in June 2021 from 13 percent in June 2020. During the same period, NPL ratio in Rwanda increased to 5.7 percent from 5.4 percent (Table 2). In Tanzania, NPL ratio remained elevated at 9.3 percent in June 2021 against 10.8 percent in June 2020. In Uganda and Burundi, NPL ratio reduced to 4.8 percent from 6 percent and to 4.7 percent from 6.2 percent. In Uganda and Burundi, the decline of NPL ratio is mainly linked to write offs and loans restructuring. In Burundi, the reduction of NPL ratio is associated with higher increase of outstanding credit and write offs. Generally, credit impairments have not yet increased to the full extent in EAC due to credit payment moratoria that banks provided to their customers affected by the pandemic. As at March 2021, 57 percent, 31.2 percent and 28.9 percent of outstanding credit had been restructured in Kenya, Uganda and Rwanda, respectively, therefore limiting credit defaults in banks. The resumption of these loans to normal payment schedule is key for the stability of the financial sector. The projected economic rebound will play a major role in improving debts service and assets quality of banks, but is this and lies on successful containment of the pandemic. Further, some economic sectors such as hotel and tourism related sectors may take longer to recover to pre-pandemic level and they would still expose the financial sector to elevated credit risk given their dependence on debts financing.

Table 2: The Selected Financial Soundness Indicators

CAR (%)	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
KENYA	18.7	18.5	15.6	16.7	16.5	18.9
TANZANIA	17.9	17.9	18.3	18.1	18.9	17.5
UGANDA	21.9	22.7	22.5	22.2	23.8	23.5
RWANDA	24.9	23.6	22.6	21.5	22.3	22.5
BURUNDI	29.7	26.2	30.6	30.1	29.0	28.8
Liquidity Ratio (%)	**Mar-20**	**Jun-20**	**Sep-20**	**Dec-20**	**Mar-21**	**Jun-21**
KENYA	52.9	55.6	55.8	57.1	57.3	54.8
TANZANIA	37.7	39.0	38.2	37.0	35.6	38.4
UGANDA	48.8	49.1	48.8	50.7	47.6	51.5
Liquidity Coverage Ratio[1] (%)	**Mar-20**	**Jun-20**	**Sep-20**	**Dec-20**	**Mar-21**	**Jun-21**
RWANDA	202.1	252.7	254.0	254.7	240.7	226.2
BURUNDI	232.0	242.8	229.0	213.5	200.9	224.0
NPLs Ratio (%)	**Mar-20**	**Jun-20**	**Sep-20**	**Dec-20**	**Mar-21**	**Jun-21**
KENYA	12. 5	13.1	13. 6	14.1	14.6	14.0
TANZANIA	11.0	10.8	10.4	9.4	9.3	9.3
UGANDA	5.4	6.0	5.1	5.3	5.4	4.8
RWANDA	5.4	5.4	5.2	4.5	6.6	5.7
BURUNDI	6.6	6.2	6.8	5.4	4.8	4.7
ROA (%)	**Mar-20**	**Jun-20**	**Sep-20**	**Dec-20**	**Mar-21**	**Jun-21**
KENYA	2.6	0.7	1.7	1.6	2.6	2.7
TANZANIA	1.9	2.2	2.2	2.0	2.4	2.4
UGANDA	3.8	3.5	3.4	3.2	3.4	2.7
RWANDA	3.2	3.2	2.7	2.8	2.9	3.6
BURUNDI	1.1	2.1	3.4	3.9	1.0	1.2
ROE (%)	**Mar-20**	**Jun-20**	**Sep-20**	**Dec-20**	**Mar-21**	**Jun-21**
KENYA	21.6	15.6	15.1	13.8	22.0	22.7
TANZANIA	8.5	9.9	9.4	7.8	10.0	10.1
UGANDA	15.9	15.2	15.1	14.2	14.7	15.5
RWANDA	11.8	11.8	9.9	11.0	11.8	14.4
BURUNDI	8.9	16.9	26.9	31.0	7.1	9.7

[1] Rwanda and Burundi adopted Basel III standards in 2018 and 2019 respectively. Other central banks are also at advanced stage in implementing this regulatory standards.

Box 1: Unwinding COVID-19 Policy Support Measures

The outbreak of the COVID-19 crisis triggered the adoption of extraordinary measures to support the economy and preserve the stability of the financial sector. The policy interventions have included fiscal, monetary and regulatory measures for the economy in general and the financial sector in particular, with the purpose of preventing a temporary shock having long-standing consequences on the economy. In EAC region, the key policy measures initiated include: i) establishing Government support funds, ii) reducing Central Bank policy Rate, iii) reducing reserve requirements, iv) imposing restrictions on dividends distribution, v) granting exceptional permission to lending institutions to restructure loans of borrowers that have been affected by the pandemic and vi) providing exceptional liquidity assistance to commercial banks among others.

The above measures are effectively supporting the economic recovery and enhancing the stability of the financial system by increasing banks' capital and liquidity, increasing lending capacity and supporting access to affordable credit for firms and households. Whilst accommodative measures have helped to contain the impact of the pandemic, they may have undesirable effects on the financial sector in the long run if kept for long time. It is believed that keeping these measures in place for too long can amount to forbearance that ultimately weakens the financial sector. In view of this, the attention has increasingly turned to the phasing-out of these support measures, while avoiding cliff-edge effects.

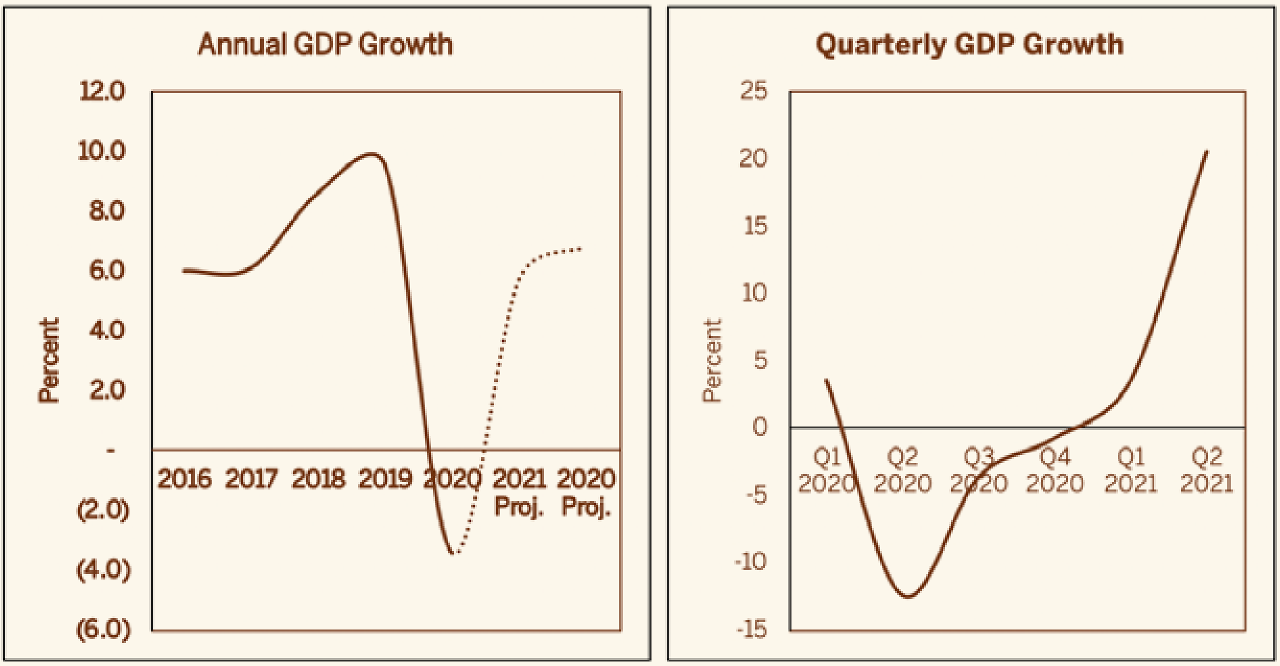
Central banks around the world are considering the timely unwinding of such measures while ensuring they are not prematurely removed. Central banks, the NBR included, are at advanced stage with arrangements for phasing out COVID-19 measures taking into consideration the timing of the recovery from the pandemic and transition period in order to avoid cliff-edge effects. Moving forward, COVID-19 support measures will be unwound in targeted and time-bound manner, with a gradual return to the standard regulatory requirements.

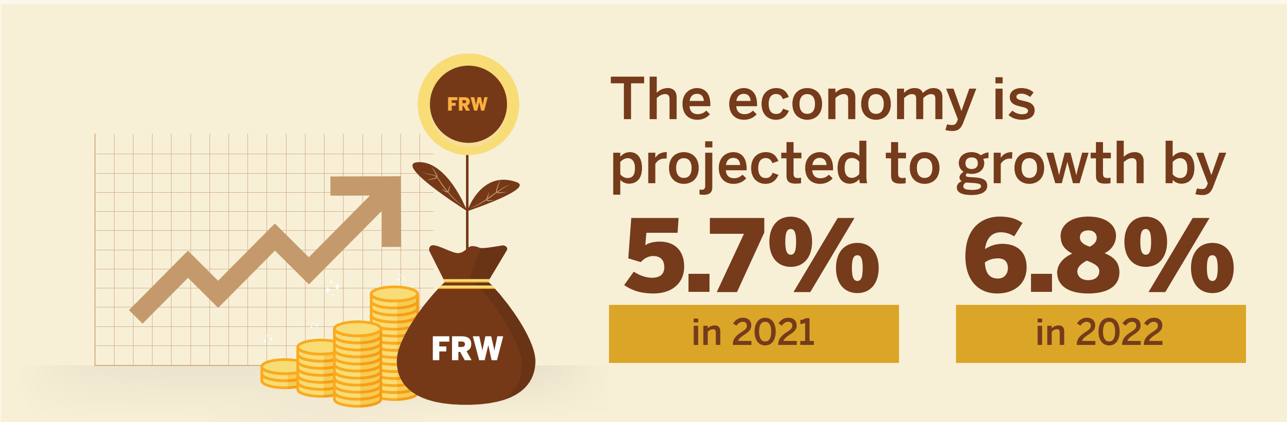
3 Domestic Macroeconomic Development

The macro financial conditions continue to be underlined by COVID-19 outbreak and measures taken to contain the spread of the virus (Box 2). The outbreak of the pandemic induced a contraction of economic activities and increased credit risk to the financial sector. Economic activities contracted by 3.4 percent in 2020 compared to the growth of 9.5 percent in 2019. The service sector that is the key driver of Rwandan economy was most effected by the pandemic. Real output in services sector contracted by 5.5 percent in 2020 against the growth of 8.3 percent in 2019. Industry sector contracted by 4 percent in 2020 compared to the growth of 17 percent in 2019. The agriculture was less affected by the pandemic as the farming activities were amongst the essential activities that were allowed to continue running. The growth of real output in agriculture sector moderated to 1 percent in 2020 from 5 percent in 2019. The strong interconnectedness between the real sector and the financial sector increased risks to the financial sector mainly through credit exposures. Top financed sectors by banks that include trade (14.5 percent), hotels (10.4 percent), commercial real estate (10.0 percent) and transport (10.5 percent) are very sensitive to the pandemic.

Timely policy interventions are paying off in supporting the economic recovery and containing risks to the financial sector. Despite recent waves of COVID-19 during H1 2021, the economic recovery is underway mainly supported by implemented policy measures, the re-opening of the economy and improved global demand. During the H1 2021, the real GDP grew on average by 12.1 percent (3.6 percent in Q1 2021 and 20.6 percent in Q2 2021) against a contraction of 4.4 percent in H1 2021. The outlook for the Rwandan economy is positive and the economic recovery is expected to strengthen in H2 2021, especially in services sector following further easing of restrictions measures. The working hours have been extended further, public transport, schools, bars and restaurants have been allowed to resume operations while observing health protocols. The economy is projected to growth by 5.7 in 2021 and further by 6.8 percent in 2022.

Figure 4: Real GDP Growth

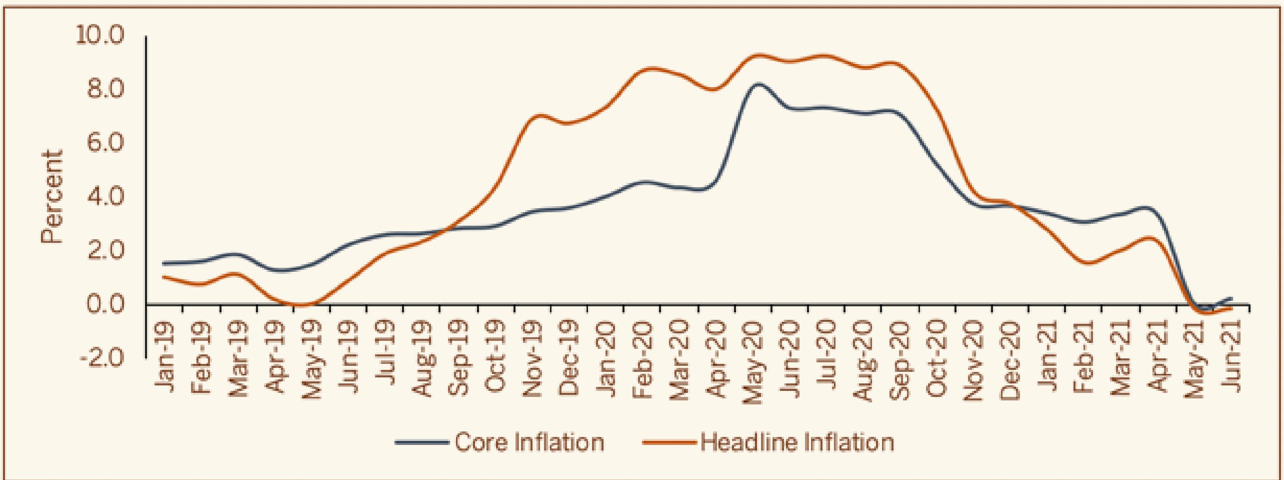




Risks arising from inflationary pressures eased during the period under review. During the year to end June 2021, inflation rate averaged 4.2 percent down from 6.3 percent during the previous year. The moderation of inflation is linked to the weak demand, subdued oil prices and good agriculture production that contained the increase of food prices. Inflation is projected to remain below central bank target in 2021 and 2022. To the financial sector, low inflation stabilizes real earnings of financial institutions, stimulates financial intermediation by lessening the cost of borrowing and eventually reduces risk to creditors. For insurers, low inflation contributes to preserving the soundness of insurance companies by easing the claims expenses.

With stable inflation outlook, the NBR monetary policy stance remains accommodative to support the economic recovery. The NBR cut the central bank to 4.5 percent in April 2020 from 5 percent and has kept it unchanged during the subsequent Monetary Policy Committee (MPC) meetings. The reserve requirement ratio has been reduced to 4 percent from 5 percent since April 2020 and this measure remains in place. Furthermore, the NBR established the extended lending facility since March 2020 in order to support to any solvent bank that may require temporary liquidity support. Complimented by establishment of the economic recovery fund by fiscal authority, these policy initiatives have played a key role in supporting the economic turnaround and the well-functioning and soundness of the financial sector. The liquidity in financial sector has been enhanced, the cost of borrowing has been eased and banks are in strong position to continue proving credit to real sector to revive businesses.

Figure 5: Inflation Rate



Source: National Institute of Statics of Rwanda

The currency risk also remained minimal during the period under review. The local currency depreciated by 1.5 percent against the United States Dollar (USD) in June 2021, the same level it was in June 2020. The stable depreciation is mainly associated with improved trade deficit in line with recovering commodity prices, improved global demand and increased remittances. During the H1 2021, trade balance widened by 0.1 percent to USD 946 million, from 12.1 percent in H1 2020. This upturn is explained by higher growth of exports (by 16 percent in H1 2021 up from 9.1 percent in H1 2020), relative to the growth of imports (by 6.1 percent in H1 2021 down from 11 percent in H1 2020). The increasing commodity prices coupled with increased global demand are expected to continue boosting exports receipts and other private inflows for the periods ahead. However, these gains could be counteracted by the increase of imports in line with the projected recovery of domestic economic activities. The depreciation of local currency is expected to remain stable in medium term due to improved global prospects and accompanying foreign inflows. To the financial sector, risks associated with exchange rate depreciation and Net Open Position (NOP) of banks will further be minimized.

Inflation rate averaged

4.2% JUNE 2021

6.3% JUNE 2020

Box 2: Implemented COVID-19 Policy Measures in Rwanda

2. 1 : Economic Recovery Fund

The government established the Economic Recovery Fund (ERF) in April 2020 to support businesses most affected by the pandemic. The ERF enhanced market confidence, liquidity conditions of banks and supported the refinancing of credit in sectors most affected by the pandemic including public transport, education sector, hotels and key MICE venues. Besides, the fund availed working capital to micro businesses, SMEs, large corporates and originated an SME guarantee scheme to de-risk SME lending. As of 10th September 2021, around FRW 89.4 billion had been disbursed of which: FRW 52.6 billion under the hotel refinancing window, FRW 12.3 billion for public transport subsidy, FRW 10.2 billion for working capital, FRW 7.2 for public transport refinancing, FRW 5.3 billion for SMEs loans and guarantees and FRW 1.8 for education. The fund remains operational and the Government plans to expand it to USD 350 million by end 2021 from initial USD 100 million.

2. 2 : Monetary Policy Measures

The monetary policy measures have mainly been the reduction of central bank rate, the reduction of the reserve requirement and extended lending facility. In April 2020, the NBR cut the reserve requirement ratio from 5 percent to 4 percent and this helped to release FRW 23.4 billion additional liquidity to banks. Further, the NBR in April 2020 reduced the central bank rate for the first time since March 2019 to 4.5 percent from 5 percent and has maintained it at that level during the subsequent Monetary Policy Committee (MPC) meetings. This measure aimed at stimulating credit intermediation by lowering the cost of funds. Subsequently, the interbank rate reduced by 26 percentage points to 5.19 percent between June 2020 and June 2021. Furthermore, the weighted average lending interest rate dropped from 16.3 percent in June 2020 to 15.9 percent in June 2021. As result, new lending increased by 26 percent in first half of 2021 after a contraction of 9.2 percent in first half of 2020. The NBR also established the extended lending facility of FRW 50 billion in March 2020. The purpose of this facility is to provide support to any solvent bank that may require temporary liquidity support. The usage of this facility remains limited due to high liquidity position of banks. Since its inception, only two banks have used this facility by borrowing FRW 5 billion in 2020 and repaid back the funds on time and further FRW 7.2 billion in 2021 that remains outstanding.

2. 3: Credit Payment Moratorium

The NBR granted banks with exceptional permission to restructure loans of distressed borrowers due to COVID-19. It avoided a one-off -increase of non-performing loans and provisional expenses due to the shock. It allowed banks and microfinances to determine and classify assets based on the long-term impact of the pandemic. Banks and microfinances provided credit payment reliefs to their customer in form of loans restructuring. As at end June 2021, banks had restructured loans worth FRW 776.7 billion (28.5 percent of total banks loans) while in microfinance sector, total restructured loans amounted FRW 12.3 billion (5.7 percent of total loans). The restructuring allowance remains in place until end September 2021 and afterwards, lending institutions will continue to transition the customers benefiting from credit relief program back to regular loan payments.

2. 4: Restriction on Dividend Distribution

The NBR imposed restriction on distribution of dividends to shareholders to enhance capitalization with retained earnings. The decision forced regulated financial institution to conserve capital in a recessionary condition- to absorb losses. In absence of this decision, these funds would have been distributed to shareholders. The restrictions on payment of dividends and other discretionary payments remains in place to ensure that financial institutions build strong capital buffers to absorb pandemic induced losses.

4 Systemic Risks Assessment

In implementing its mandate of preserving the stability of the financial sector, the NBR regularly monitors financial sector risks with the ultimate objective of implementing the necessary mitigation policies. Risks assessed by NBR refer to existing or evolving conditions in the financial sector that pose vulnerabilities when faced with economic and financial shocks. These risks relate to the structure of the financial sector, the interconnectivity of sub-sectors and institutions, the structure of asset portfolios and, the status of household and corporate sector balance sheets. The sections that follow highlight the key risks that were recently identified in the financial sector with data as at end June 2021 and measures taken to mitigate them.

Credit Risks

COVID-19 elevated credit risk in the banking sector, especially in sectors most affected by the pandemic. The containment measures taken to limit spread of the pandemic meant that several businesses had scaled down their activities, as only essential services were allowed to operate during the lockdown, resulting in a loss of income and weak borrowers' earnings to service their debts. As a consequence, the outstanding NPLs increased by 27 percent to FRW 179 billion in June 2021 from FRW 141 billion in June 2020. During the same period, NPLs ratio increased to 5.7 percent from 5.4 percent. The increase of credit defaults is highly observed in economic sectors that were most affected by the pandemic including hotels and commercial real estate. NPLs ratio in commercial real estate increase to 16 percent in June 2021 from 9.3 percent in June 2020. During the same period, NPL ratio in hotels increased to 9 percent from 3.8 percent.

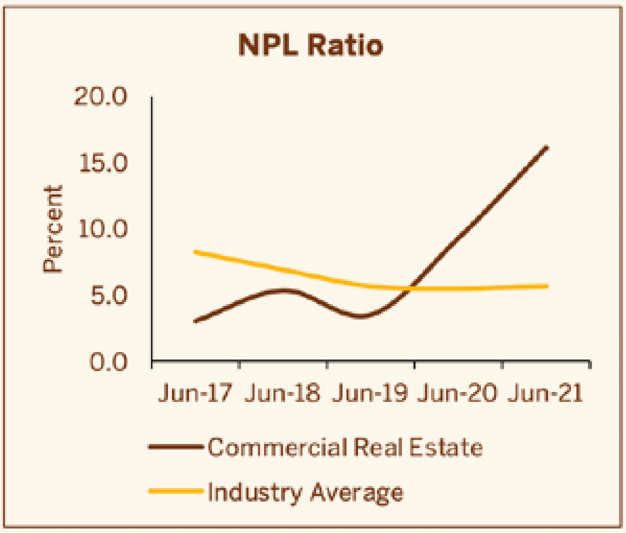
The increase of watch loans and extent of loans restructured due to COVID-19 are also indicative of increased credit risk in the banking sector. Watch category loans (loans whose repayment is late by 30 to 90 days) increased by FRW 265 billion, from FRW 157 billion in June 2020 (6.0 percent of total loans) to FRW 422 billion in June 2021 (13.2 percent of total loans). During the economic downturn, these loans have a high probability of default. With regards to credit restructuring, banks had restructured loans worthy FRW 776.7 billion (28.5 percent of total banks loans) as at end June 2021 out of which FRW 215.3 billion (7.9 percent of total loans) were still under moratorium. In view of this, the NBR requested banks to proactively assess borrowers' repayment capacity, determine the level of problem loans, appropriately classify them and make provision accordingly. Getting the economy back on track will provide lifeline towards improving assets quality of banks and the overall soundness of the financial sector.

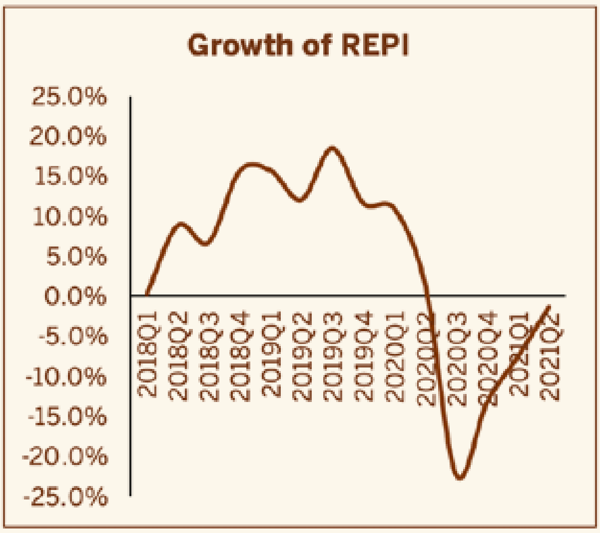
Banks' Exposure to Commercial Real Estate

Banking sector exposure to commercial real estate is significant. Commercial real estate is among the most financed sectors accounting for 10.5 percent of total banks loans and averaged 12 percent over the past five years. Due to this high exposure, banks are particularly vulnerable to adverse performance of this sector. Following the outbreak of the pandemic, credit risk related to banks' exposure to commercial real estate has increased. Non-performing loans ratio for commercial real estate has increased to 16 percent as at end June 2021, from 9.3 percent in June 2020 and 3.6 percent in June 2019. The deterioration of assets quality in commercial real estate is mainly associated with a reduction of rental income that weakened the loans servicing capabilities of proprietors of commercial houses. The commercial real estate survey conducted by the NBR in August 2020, indicated that occupancy rates dropped and many property owners proactively offered rental discounts to support tenants during the downturn of economic activities that prevailed through much of Q2 2020. All these affected the revenue streams of commercial property owners and thus their ability to service loans.

Furthermore, credit risk related to commercial real estate has increased through the collateral channel. Commercial real estate tends to show high sensitivity to worsening economic conditions and the pandemic has increased risk of a broader decline in property prices due to a deterioration in income and weaker demand conditions. This in turn increased risk to stability of the financial sector given that properties are the main collaterals to the banks.

Figure 6: Assets Quality and Real Estate Price Index





Banks’ Exposure to Hotel Sector

Banks’ exposure to the hotel sector constitutes another source of vulnerability to the financial sector. Credit to the hotel sector has increased to FRW 268 billion in June 2021 (10.4 percent of total bank loans) from FRW 199 billion (9.0 percent of total bank loans) in June 2020 and FRW 146 billion in June 2019 (7.6 percent of total bank loans). The challenges created by COVID-19 impact almost every part of a hotel’s business, from room occupancy levels to the provision of catering services. Measures implemented to limit the spread of COVID-19 such as lockdowns, travel and stay at home restrictions led to sharp decline in hotel occupancies and revenues. In particular, the performance of the hotel sector much depends on the tourism activities and with the decline in international tourism, significant hotel capacities remained unused, negatively affected cash flow and debt repayment capabilities.

As a result, the NPLs ratio for the hotel sector increased to 9 percent in June 2021 from 3.8 percent in June 2020. The increase of NPLs in the hotel sector would have been even higher without credit repayment reliefs that banks provided to their customers by way of credit extensions and restructuring. To assist the hotel sector overcome the challenges posed by the pandemic, half of the government’s FRW 100 billion Economic Recovery Fund for the private sector was allocated to the Hotel Refinancing Window. As at September 30, 2021, FRW 52.6 billion (100 percent) of the allocated amount had been disbursed. The refinancing window for hotels was aimed at reducing their debt repayment burden by restructuring 35 percent of loans outstanding at the end of February 2020 at a more affordable interest rate of 5 percent (compared to the average lending rate of 16 percent), extending the tenor over a 15-year period and granting a 3-year grace period to allow borrowers recover business activity before resuming their loan repayments. The remaining 65 percent was maintained at pre-existing terms and conditions even but with varying grace periods ranging between 1 and 3 years. While the global economy is recovering and containment measures are eased further, the hotel sector will benefit from increased demand for tourism and leisure and eventually boost their earnings prospects to service loans. However, the recovery of tourism sector may take sometime to take full effect therefore creating challenges for the hotel sector and financial institutions that deal with hotels.

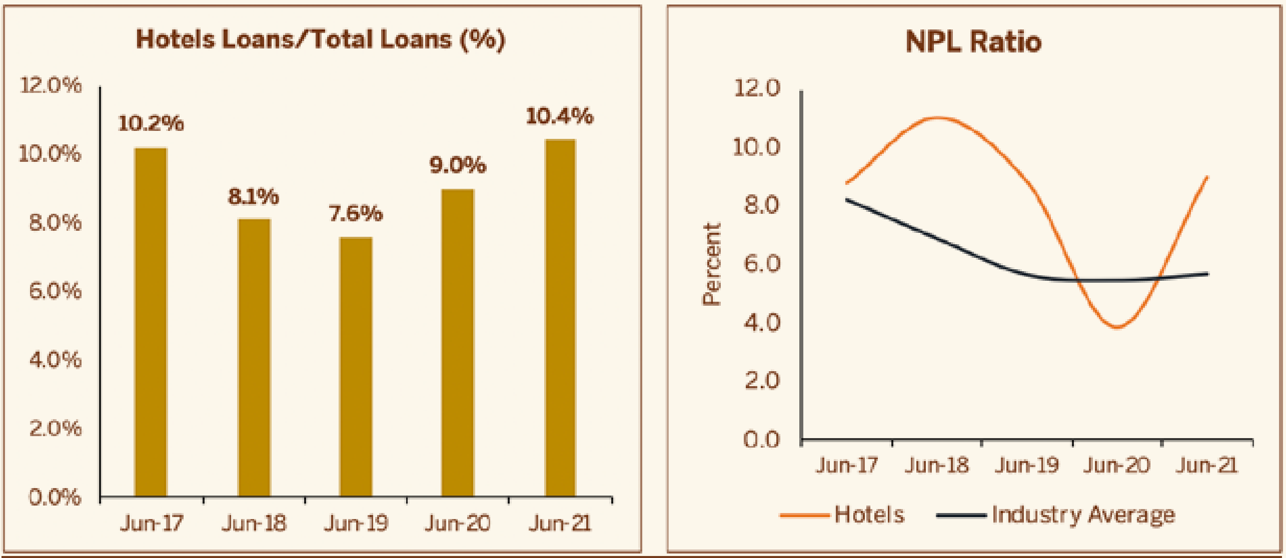
Credit to the hotel sector has increased to

FRW268Bn JUNE 2021 — 10.4 % of total bank loans

FROM

FRW199Bn JUNE 2020 — 9.0 % of total bank loans

Figure 7: Banks’ Exposure to Hotel Sector



Source: NBR, Financial Stability Directorate

Loan Recoverability

Timely loan recovery is important for the stability of the banking sector as it constitutes the cash flow for banks and provides banks with the chance to earn an income in alternative investments. One of the key features of the banking sector is market risks associated with low recovery from bad loans. The NBR conducts an annual survey on collateral realization with the purpose of assessing the quality of collateral property valuation in banks. The findings of the recent survey that was conducted in May 2021 indicated that from collaterals sold, banks only recovered 36.6 percent and 29.8 percent of total outstanding loans in 2019 and 2020 respectively. Relative to the initial amount borrowed, banks recovered 39.7 percent in 2019 and 33.2 percent in 2020.

The low recoverability is mainly attributed to improper valuation of properties at the initial loan application stage, fraud and malpractices during auctions, interference and speculation of brokers, lack of bidders among other things. Going forward, the recently launched electronic bidding platform is expected to provide a long-term solution to issues related to the receivership process but there is a need of public awareness for this new platform. Further, improvement of property valuation standards and putting in place the code of conduct of property valuers will contribute to enriching the professionalism of valuers an ultimately to taming losses anchored on property valuation.

Table 3: Recovery Rates from Collateral Auctions

Recovery Rate	2019	2020
Auction Proceeds/ Borrowed Amount	39.7%	33.2%
Auction Proceeds/Outstanding Amount	36.6%	29.8%
Auction Proceeds/Initial Valuation	59.9%	41.2%
Auction Proceeds / Last Valuation	74.3%	45.8%

Source: Survey Findings

Risks Arising from Interconnectedness of Insurance and Banking

Potential transmission channel of exposure between the insurance sub-sector and the rest of financial sub-sectors (mainly banks) relies on the insurers' investments made in the banking sub-sector. It is crucial to identify and monitor the level of exposures through all potential risk transmission channels in order to mitigate systemic risk. As at June 2021, the insurance sector holds 40 percent of its assets in Banks as placements and 2 percent as equities invested in Banks. Public insurers are more interconnected with banks than private Insurers. During the period under review, total investments of public insurers in banks account for 58 percent (FRW 205.2 billion) of insurers' investments, while private insurers held 36 percent of their investments in Banks (both placements & equities). The interlinkage between Banks and Insurers is viewed as source of potential systemic risk, and NBR will continue to closely monitor of these sub-sectors to ensure the stability of entire financial sector.

Credit Risks in the Insurance Sector

Premium receivables in private insurers increased from FRW 12.3 billion in June 2020 to FRW 15.8 billion in June 2021, following NBR's guidance to insurers to provide flexibility on premium payment schedules to support policyholders in this period of COVID-19 pandemic. These premium receivables represented 6.6 percent of private insurers' assets as at end June 2021, compared to 3.7 percent in March 2021 and 6.1 percent in June 2020. A significant proportion of these receivables, 61 percent were overdue for less than 90 days, 10 percent between 90 to 180 days and 28 percent are above 180 days. Corporates represented 70 percent of the total premium receivables, public institutions 23 percent, individuals 5 percent, and NGOs and international agencies 2 percent. The NBR granted regulatory forbearance to allow insurers to sell on credit and with admissibility of premium receivables less than 90 days until June 2021. Going forward, admissibility of premium receivables will revert to less than 60 days for government institutions and 30 days for corporates. Besides, NBR will continue monitoring the growth of these receivables, as well as, their impact on the liquidity positions of insurers, and take necessary measures where risks are increasing.

Risks Arising from Structural Concentration.

Rwanda's Insurance market has for a long time been dominated by two public medical insurers, and represent 62.9 percent of the insurance sector's assets and 43 percent of gross written premiums. The two Insurers provide the medical insurance cover mainly to the employees of the public institutions and small number of private sector' employees. From macro prudential perspective, this level of insurer concentration ratio (above 50 percent), may translate into a systemic risks. Any shocks to these Insurers may be contagious to the other financial institutions—mainly banks as these Insurers remained large institutional investors, especially in the banking sector. As at June 2021, these Insurers held FRW 194.1 billion as placements in Banks (76 percent of all Insurers' placements invested in Banks) and FRW 11.1 billion as equities in Banks (only public insurers held equities in Banks). High Insurer concentration level may also complicate the substitutability of failed Insurer by another Insurer providing the same products (medical insurance) to policyholders. Insurers with high market share are closely monitored and supervised in order to ensure their soundness and thus ensuring low level of systemic risk.

Further, to address this issue of systemic risk and fostering financial stability, the NBR is process of developing a framework for regulation and supervision of Domestically Systemically Important Insurers (D-SIIs). The framework specifies the assessment methodology for identifying and monitoring D-SIIs and additional regulatory requirements for identified D-SIIs. A systemically important Insurer is defined as an Insurer whose failure might largely disrupt the functioning of the entire financial system, with far reaching impact on the economy. D-SIIs are a risk to the financial stability due to their scope, position, the nature of the business, and their interconnection in the financial system is such that their distress or failure might cause disruption to the wider financial system and the real economy. By implementing this policy tool, the NBR is aiming at creating stronger risk management practices that would reduce the systemic risk that SIIs pose to the financial system. (Box 3 discusses D-SIIs framework to be adopted soon by the NBR).

Table 4: Insurer Concentration Ratio by Type of Insurers.

Description		Jun-17	Jun-18	Jun-19	Jun-20	Jun-21
The sector's total assets (FRW billion)		367.5	423	477.3	548.4	637.8
Share of assets by type of Insurer						
Non-life Insurance	10 Private non-life Insurers	26.8	26.6	26.2	26.5	27.0
	2 Public Health Insurers	62.6	62.8	63.4	63.3	62.9
Life Insurance	3 life Insurers	10.6	10.6	10.4	10.2	9.9
Micro-insurance	1 Insurer	-	-	-	-	0.2

Source: Survey Findings

Insurers recorded a growth in assets of

637.8Bn JUNE 2021 FROM **548.4BN** JUNE 2020

Box 3: A methodology to identify and supervise Domestic systemically important Insurers (D-SIIs).

The failure or distress of significant Insurers can pose the impact on other financial institutions' failure or severe distress to the stability of the financial system and the real economy. Global/Domestic Systemic Important Insurers (G-SIIs/D-SIIs) are a risk to the financial stability due to their scope, position, the nature of the business, and their interconnection in the financial system is such that their distress or failure might cause disruption to the wider financial system and the real economy. Although, it has always been argued that insurers do not amplify the systemic risks to the financial system. However, there is no guarantee that Insurers may not pose systemic risk in the future.

Though Insurance sector was not thought to pose significant systemic risks before global financial crisis of 2007-2009, but later, this global financial crisis has shown and put the insurance sector on the map as a source of systemic financial risk. In effect, Insurers have longer-term liabilities (especially life insurers) than banks, greater diversification of assets, and less extensive interconnections with the rest of the financial system. It was assumed that the functions of any failed Insurer would be relatively easily picked up by others. However, the near-collapse of the insurer AIG (American International Group, Inc.) during the crisis prompted a rethinking of the sector's systemic risk contribution.

Afterwards, the Financial Stability Board (FSB) and the G-20 leaders prioritized more intense and effective supervision of financial institutions, in particular focusing on global systemically important financial institutions (G-SIFIs). In November 2011, the Basel Committee of Banking Supervision (BCBS) issued their rules text and assessment methodology for global systemically important banks (G-SIBs). Later in July 2013, the international association of insurance supervisors (IAIS) developed the assessment methodology used to identify global systemically important Insurers (G-SIIs). The 2013 methodology was indicator-based and premised upon the BCBS's G-SIBs methodology. However, the specific nature of the insurance sector has influenced the selection, grouping, and weights assigned to certain indicators.

It is against this backdrop that, the National Bank of Rwanda (NBR) is in process of issuing an oversight framework for D-SIIs for Rwanda. This initiative is in tandem with IAIS and other global initiatives where each jurisdiction or country designs a policy framework for the identification and regulation of their D-SIIs to limit the economic impact of insurer's distress and promote financial system stability. The framework will discuss the analytical framework for identifying and benchmarking systemically important financial institutions. Firstly, it will set out the main concepts underlying the SIIs definition. Next, it turns to the methodologies used for identifying and categorizing systemically important insurers. Finally, the framework put in place requirements for identified D-SIIs.

The objective of this framework is expected to address the issue of systemic risks in the financial sector and its relevance with regard to insurance activities to eventually enhance the NBR's macro-prudential toolkit for mitigating systemic risks. In addition to intensive supervision, each type of D-SIIs will be subject to appropriate policy measures. The main objectives of the policy measures are three-fold: (1) to reduce the probability and impact of failures of SIIs and create incentives for the reduction of the systemic risk of SIIs by more stringent recovery planning; (2) to reduce moral hazard and reduce the possibility of disorderly failure of SIIs by requiring higher loss absorbency as well as increased the intensity of supervision of SIIs; (3) to comply with international best practices of supervising SIIs.

5 The Resilience of the Financial System

The financial system continue to be stable and resilient to the COVID-19 shock. The regulated financial institutions continued to hold enough capital and liquidity buffers and the support measures implemented to cushion the impact of COVID-19 have ensured that the financial sector has so far coped with the challenges of the pandemic relatively well. In face of the COVID-19 pandemic, credit risk from declining loan quality remains the main risk to financial stability. The regulatory policy measures, in form of loans payment moratorium and restructuring, implemented since the onset of the pandemic have lessened the magnitude of impact on assets quality of lending institutions. The projected economic rebound will play a major role in improving debts service and assets quality of banks, but is this and lies on successful containment of the pandemic. Looking ahead, the financial sector is expected to remain stable on account of gradual turnaround of the economic activities and the ample capital and liquidity buffers that financial institutions currently hold and are expected to be deployed to absorb the emerging shocks.

The Stability of the Banking Sub-Sector

The banking sector was adequately capitalized at the onset of this COVID-19 crisis. Banks came into this crisis with sufficient capital buffers and these have been crucial in safeguarding the stability of the sector against any shocks so far. The aggregate core CAR stood at 21.4 percent in June 2021 (June 2020: 22.3 percent) higher than the minimum regulatory requirement of 12.5 percent, while the total CAR stood at 22.5 percent as at end June 2021 (June 2020: 23.6 percent) compared to the minimum prudential requirement of 15 percent. The stable capitalization of banks is mainly explained by capital injection and retained earnings. Paid up capital increased by FRW 37 billion to FRW 371 billion in June 2021 as some banks enhanced their capital positions to match risks undertaken as well as meet the minimum required paid up capital in line with the 2019 Licensing Regulation that requires commercial banks to have increased minimum paid up capital to FRW 15 billion by end 2021 and FRW 20 billion by 2023.

Domestic Systemically Important Banks (D-SIBs) held sufficient capital buffers including the Higher Loss Absorbency (HLA) Requirement. As a macro prudential authority, the NBR also imposes specific capital requirements on Domestic Systemically Important Banks (D-SIBs) in order to enhance their resilience, taking into account the high financial and economic costs of their failure. According to the NBR framework for identifying D-SIBs, a bank designated as a D-SIB is required to maintain higher capital buffers to meet regulatory capital requirements that include a Higher Loss Absorbency (HLA) requirement. This serves to increase a D-SIB's capacity to absorb losses thereby reducing its probability of distress or failure during periods of stress. The capital surcharge imposed depends on the systemic importance of the bank and ranges between 0.5 percent and 1 percent of Risk Weighted Assets (RWA). The recent D-SIBs identification exercise that was conducted in June 2021 has indicated that all banks designated as D-SIBs comply with HLA requirement.

Going forward, banks are expected to remain adequately capitalized though capital buffers could reduce in the near term as credit impairments increase. Banks prepared and submitted their Internal Capital Adequacy Assessments (ICAAP), which were then reviewed and discussed with the supervisors under the Supervisory Review and Evaluation Process (SREP) to ensure that banks effectively assess challenges and risks to capital posed by the crisis and implement sufficient mitigating controls.

Liquidity of the banking sector remains healthy. The Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR), the key liquidity indicators of banks, were above the minimum prudential requirement. Prescribed at a minimum level of 100 percent, the LCR stood at 226.2 percent compared to 253 percent in June 2020, while the NSFR stood at 157.4 percent as at end June 2021 compared to 164 percent in June 2020. The LCR and NSFR act as safeguards against short-term funding outflows and excessive maturity transformation risks respectively. The compliance with both LCR and NSFR suggests that banks have sound short term and long-term funding profiles.

Banks operate conventional business models in which the balance sheet is primarily funded by customer deposits. Customer deposits represented 61.3 percent of total assets of banks (June 2020: 63.3 percent) and 74.1 percent of total liabilities (June 2020: 76.8 percent). Deposits increased by 16.2 percent to FRW 2,836 billion as at end June 2021, albeit slower than 17.8 percent growth registered in June 2020. Demand deposits represented 60.3 percent of total deposits while term deposits accounted for 39.7 percent. 90.9 percent of the term deposits have a maturity of less than one year. The share of borrowings from domestic banks and the NBR increased from 14.9 percent to 15.7 percent. This is reflective of the easing of interbank funding costs in line with the reduction in the Central Bank Rate to 4.5 percent in April 2020. Consequently, the average interbank rate declined from 5.5 percent in June 2020 to 5.2 percent in June 2021. During the same period, shareholders' funds increased by FRW 120 billion (y-o-y) to FRW 677 billion mainly supported by the increase of profits and capital injections.

Banks are expected to remain liquid. Based on the above-mentioned liquidity buffers, banks are expected to remain liquid. However, there are downside risks associated with loans still under moratorium that continue to hold up liquidity in the medium term, the potential increase in non-performing loans as well as delayed realization of collaterals held that could further reduce cash inflows and increase liquidity risk. The NBR remains ready to support solvent banks that may experience any short-term liquidity challenges.

Credit risk escalated during the pandemic and remains one of the main threats to the stability of the banking sector. The Non-Performing Loans (NPLs) ratio, the key indicator of asset quality of banks, increased to 5.7 percent in June 2021 against 5.4 percent in June 2020. In nominal terms, NPLs increased by 27 percent to FRW 179 billion. Banks wrote off long outstanding NPLs of FRW 22.3 billion during the six months ended June 2021 resulting in a share of written off loans to gross loans of 12.1 percent. In addition, watch category loans (loans whose repayment is late by 30 to 90 days) increased by FRW 265 billion, from FRW 157 billion in June 2020 (6.0 percent of total loans) to FRW 422 billion in June 2021 (13.2 percent of total loans). These trends are indicative of the significant increase in credit risk.

Banks responded to the pandemic by offering loan repayment deferrals for customers affected by the crisis through loan restructuring. As at end June 2021, restructured loans amounted to FRW 776.7 billion (28.5 percent of total banks loans) out of which FRW 215.3 billion (7.9 percent of total loans) were still under moratorium. The initial guideline provided to banks in June 2020 with regard to COVID-19 loan restructuring was due to expire in June 2021 but was extended to September 2021. In addition to the extension, banks were required to strengthen the governance framework around COVID restructured loans to ensure thorough analysis of the borrowers' likeliness to repay the rescheduled payments and other related risk management frameworks, classify all restructured loans still under moratorium as watch category loans considering the significant increase in credit risk, consider 3 years for commercial properties, 2 years for residential properties and 1 year for movable properties as the collateral realization period in the computation of Expected Credit Loss (ECL) as well as extend the deadline for the disposal of assets held for sale to end December 2021.

NPL ratio is already elevated in some of the sectors that have been the most affected by the pandemic notably hotels, commercial real estate and trade (Table 5). In anticipation of increased future losses, banks have increased provisions by FRW 59 billion to FRW 177 billion in June 2021 from FRW 118 billion in June 2020. As a result of the faster increase of provisioning reserves compared with the stock of non-performing loans, the provisioning coverage ratio increased to 99 percent in June 2021 from 83.3 percent in June 2020. The increase of the provision coverage ratio signals that banks are cognizant of heighted risks and are prepared to strengthen safeguards against such risks.

Table 5: Assets Quality of Banking Sector

Activity Sectors	NPLs Ratio (Percent)			Percentage Share in Total NPLs
	Jun-19	Jun-20	Jun-21	
Personal Loan	6.0	7.4	5.9	8.2
Agricultural & Livestock	5.0	4.8	2.6	0.5
Mining	88.4	80.4	0.1	0.0
Manufacturing	1.4	0.6	0.8	1.6
Water & Energy	0.0	0.0	0.0	0.0
Mortgage	3.8	5.5	8.0	45.4
Public Work	2.3	3.2	5.9	7.7
Residential Houses	4.9	4.3	3.7	9.8
Commercial Houses	3.6	9.3	16.0	27.9
Trade	15.6	10.8	8.1	20.9
Hotels	8.8	3.8	9.0	16.2
Transport &Communication	2.3	1.4	1.5	2.8
OFI	1.7	1.1	2.4	0.1
Other Services	6.7	8.2	4.3	4.2

Source: NBR, Financial Stability Directorate

The banking sub-sector was profitable during the period under review. The aggregate net profits of banks increased by FRW 23 billion (69 percent increase) to FRW 56 billion for the first half of 2021, compared to the growth of FRW 7 billion (26 percent growth) during the first half of 2020. As result, the Return on Assets (ROA) increased to 2.5 percent in the first half of 2021 from 1.8 percent in first half of 2020. During the same period, the Return on Equity (ROE) increased to 14.4 percent from 9.9 percent.

Banks' revenues continued to increase in 2021. Revenues increased by 21 percent in the first half of 2021 to FRW 297 billion compared to the 10 percent growth recorded for the same period in 2020. Interest income on loans, which represents 64 percent of total bank revenues increased by 20 percent in 2021 compared to 11 percent in 2020. The growth in interest income on loans is in line with the growth of outstanding loans. Similarly, interest on government and other securities increased by 39 percent (FRW 10 billion) in accordance with the growth in amounts invested in these securities. Non-funded income represents only 20 percent of banks' incomes and increased by 14.4 percent having declined by 3.9 percent in June 2020. The growth was driven by a recovery in fee and commission income as a result of the uptick in lending activity which generated additional loan processing and related fees, resumption of digital payments related fees following the expiration of the 90 waivers in June 2020 in order to promote cashless payments, and pick up of trade which generated trade finance incomes.

Expenses on the other hand, increased by 10 percent, slower than the growth in income. Total expenses of banks increased by FRW 20 billion, from FRW 196 billion in H1 2020 to FRW 216 billion in H1 2021, compared to the increase of FRW 15 billion in H1 2020. This increase was mainly driven by additional provisions for bad loans which increased by FRW 7.8 billion (20 percent increase) to FRW 47 billion compared to an increase of FRW 2 billion (6 percent) in June 2020. This is on the back of the increase in NPLs, write offs and watch category loans mentioned earlier. Other interest expenses increased by FRW 4.9 billion (33 percent increase) to FRW 19.5 billion compared to the FRW 848 million (6 percent) increase in June 2020 in line with the increase in interbank and other borrowings mentioned in the previous section. Salaries, wages and staff costs increased by FRW 4 billion (10 percent increase) to FRW 45 billion having declined by FRW 929 million (2 percent) in June 2020. The increase of staff costs is mainly linked accruals for bonuses. Similarly, interest on customer deposits increased by FRW 4 billion (10 percent) to FRW 46 billion having increased by FRW 7.6 billion (22 percent) in June 2020. This was due to the moderation of the growth of deposits to 16.2 in June 2021 compared to the growth of 17.8 percent in June 2020.

Banks' efficiency improved in 2021. Total cost to total income ratio reduced to 72 percent from 80 percent in June 2020 on the back of faster increase in revenue than in expenditure. The ratio of operating expenses (staff costs, premises and depreciation and other expenses) reduced from 41 percent to 35 percent while operating expenses to net income (total income less interest expense) reduced from 53 percent to 44 percent. Continued operational efficiency will be a key driver in improved profitability of the sector going forward which is crucial for the internal generation of capital.

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

Indicators	Jun-17	Jun-18	Jun-19	Jun-20	Jun-21
Total CAR (min 15 %)	20.8	21.9	23.3	23.6	22.5
Tier 1 CAR (Core CAR)	19.2	20.1	21.8	22.3	21.4
NPLs Ratio	8.2	6.9	5.6	5.5	5.7
Provisions / NPLs	44.9	67.4	80.2	82.6	99.0
Return on Average Assets	1.7	1.6	1.6	1.8	2.5
Return on Average Equity	9.6	9.5	9.3	9.9	14.4
LCR (min 100%)	-	299.5	180.5	253	226.2
NSFR (min 100%)	-	224.7	164.3	164.3	157.4
FX Exposure/Core Capital (± 20%)	-6.1	-6.1	-8.6	-6.6	-4.7

Source: NBR, Financial Stability Directorate

69%

The aggregate net profits of banks increased by

FRW 23 BN
FIRST HALF OF 2021
FROM
FRW 7 BN
FIRST HALF OF 2020

The Stability of the Microfinance Sector

The microfinance sub-sector remains adequately capitalized and liquid. As at end June 2021, the aggregate CAR of MFIs stood at 35.4 percent, higher than 15 percent minimum prudential requirement. The solid capitalization of MFIs is associated with the expansion of the capital base and improved asset quality. Total equity of MFIs increased by FRW 23 billion to FRW 137 billion in June 2021. The upturn of capital of MFIs came from paid up capital (FRW 6 billion), retained earnings (FRW 2 billion), current profits (FRW 8 billion) and other equity that includes reserves (FRW 7 billion). The capitalization of MFIs is expected to remain sound on account of profitable operations of MFIs and the extension of the NBR directive restricting the distribution of dividends to shareholders. This directive has been extended to ensure that MFIs preserve capital buffers to absorb pandemic related shocks. Further, the liquidity position of MFIs also remains strong. The industrywide liquidity ratio of MFIs stood at 106 percent, against 30 percent minimum prudential requirement. The liquidity buffers will help MFIs to absorb any shocks associated with the current COVID 19 crisis.

Asset quality continued to improve during the period under review. NPLs of MFIs dropped by FRW 9 billion to FRW 14 billion in June 2021 from FRW 23 billion in June 2020. During the same period, the NPL ratio declined to 6.6 percent from 12.8 percent mirroring the economic recovery in the first half of 2021 following the resumption of business activity. It is worth noting that unlike banks, most of the MFI loans are short term in nature and are predominantly in the agriculture sector which was not significantly affected by the pandemic. Asset quality improved in all other categories of MFIs. In U-SACCOs, NPLs dropped by FRW 4.4 billion to FRW 6.2 billion in June 2021. During the same period, NPLs ratio in U-SACCOs declined to 10.6 percent from 21.8 percent. In PLCs, NPLs dropped by FRW 3.1 billion to FRW 4.3 billion in June 2021 from FRW 7.4 billion in June 2020. Similarly, NPLs ratio in PLCs reduced to 6 percent from 12.4 percent. In non U-SACCOs, NPLs dropped by FRW 1.6 billion to FRW 3.5 billion in June 2021 from FRW 5.1 billion in June 2020. During the same period, NPLs ratio in non U-SACCOs declined to 4.3 percent from 7.1 percent. The other aspect that contained the growth of NPLs in MFIs relates to the credit restructuring. Like in banks, MFIs were also allowed to provide credit payment reliefs to their customers affected by the pandemic. As at end June 2021, MFIs had restructured loans worth FRW 12.3 billion (5.7 percent of total loans).

The microfinance sector remains profitable. During the period under review, net profit of MFIs increased by FRW 8 billion to FRW 9 billion in the first half of 2021 from the profit of FRW 1 billion in first half of 2020. The increase of the profit of MFIs is mainly linked to the reduction of operating expenses and provisions for bad debts. On one hand, the operating expenses reduced by FRW 1.3 billion to FRW 22.9 billion during the first half of 2021 from FRW 24.2 billion during the first half of 2020. On the other hand, provisions expenses reduced by FRW 2.1 billion during the first half of 2021 compared to the increase of FRW 5.4 billion during the first half of 2020. The reduction of provisions for bad debts is reflective of improved assets quality of the sub-sector as explained above. With increased profits, the ROA increased to 4.8 percent in June 2021 from 0.7 percent in June 2020 while the ROE on equity increased to 13.5 percent from 1.9 percent.

Total equity of MFIs increased by

FRW 137 bn
JUNE 2021
FROM
FRW 23 bn
JUNE 2020

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

Microfinance Sector	Jun-17	Jun-18	Jun-19	Jun-20	Jun-21
Capital Adequacy Ratio (%)	33.3	32.5	33.8	34.5	35.4
NPLs Ratio (%)	12.3	8.0	6.7	12.8	6.6
Liquidity Ratio (%)	99.1	103.3	108.8	110.1	106.1
U-SACCOs	**Jun-17**	**Jun-18**	**Jun-19**	**Jun-20**	**Jun-21**
Capital Adequacy Ratio (%)	31.4	32.2	31.9	32.8	33.6
NPLs Ratio (%)	13.1	12.3	12.5	21.8	10.6
Liquidity Ratio (%)	112.8	117.7	117.5	113.2	106.9
Public Limited Companies	**Jun-17**	**Jun-18**	**Jun-19**	**Jun-20**	**Jun-21**
Capital Adequacy Ratio (%)	23.8	20.5	23.2	22.2	24.9
NPLs Ratio (%)	20.9	8.7	5.2	12.4	6.0
Liquidity Ratio (%)	61.6	72.6	77.6	82.1	78.6
Other SACCOs	**Jun-17**	**Jun-18**	**Jun-19**	**Jun-20**	**Jun-21**
Capital Adequacy Ratio (%)	44.8	43.1	47.0	48.7	48.2
NPLs Ratio (%)	4.6	4.2	3.7	7.1	4.3
Liquidity Ratio (%)	96.5	102.5	138.5	157.8	165.7

Source: NBR, Financial Stability Directorate

The Stability of the Insurance Sector

The insurance sector remained adequately capitalized during first half of 2021. Private insurer's solvency ratio stood at 147 percent as at end June 2021 compared to 156 percent in June 2020 and well above the regulatory minimum of 100 percent. Factors that supported the insurer's solvency position in June 2021 include increase of retained earnings (+ FRW 11.2 billion) and fresh capital injections (+ FRW 1.5 billion). The solvency position of public insurers remained far above solvency requirements, in line with stable business of these Insurers (Table…). The untiring threat of COVID-19 could still place additional downward pressure on profitability and thus solvency ratios in the insurance sector. Therefore, the timing and expedite of the vaccine roll-out remains key important factor of the sector's performance over the short to medium term.

NBR is embracing new standards and modern regulatory & supervision approach to ensure the stability of the sector in line with recent market developments in insurance business. In this context, NBR has embarked on introducing a new supervision framework "risk based supervision framework", to replace the current compliance based supervision framework. The latter institutes solvency ratio that requiring all Insurers to hold the same amount of capital resources, regardless of their risk profile. In a move to implement holistic risk based supervision framework, NBR started to implement Risk Based Capital adequacy (RBC) approach as pillar I in this framework, requiring the Insurer to hold capital level based on the size, complexity and risk profile of each individual Insurer. The introduction of this new approach is expected to further strengthen the resilience, while also stirring growth potentials in the insurance industry. (Box 4 discusses RBC approach in detail).

Box 4: Risk Based Capital (RBC) Requirements

Global financial regulatory settings are changing rapidly and challenging the existing approaches to supervision and regulation of financial sector. New developments in supervision and regulation have brought another approaches to ensure effective supervision of financial institutions. International Association of Insurance Supervisors (IAIS), a global standard setting organization requires its members (Insurance regulators) in different jurisdictions to apply core principles for effective insurance supervision, with an emphasis on insurance core principle 16 , which specifies the importance of insurers of having in place an effective Enterprise Risk Management for Solvency Purposes. Globally, many regulators have established enterprise risk management requirements for solvency purposes that encourage insurers to phase out compliance-based approach to supervision and regulation and a shift towards effective risk-based supervision to ensure financial safety and soundness.

Therefore, Solvency II framework — a risk based supervision framework, developed by European Union member states, introduced for the first time a harmonized, sound and robust prudential framework for insurers, and reflects level supervision pegged on Insurer risk profile. Solvency II is based on 3 pillars: (i) pillar I that deals with quantitative requirements, insurer must satisfy and have adequate capital resources aligned with the underlying risks of an insurer by using total balance sheet approach (risk based capital requirements); (ii) qualitative requirements that relate to governance and other supervisory review processes, which are envisaged to enhance approach to risk-based supervision of insurers; (iii) Pillar III deals with disclosure requirements — relate to reporting tools and disclosure and transparency requirements.

NBR has been using the compliance based supervision framework, since the enactment of the insurance law in 2008. The framework prescribes rules to be abided by all insurers and also requires all insurers to hold the same level of capital resources, regardless of their risk profile. In a move to implement holistic risk based supervision framework, NBR started to implement Risk Based Capital adequacy (RBC) approach as pillar I of Solvency II approach. RBC approach determines the required level capital resources based on the size, complexity and risk profile of each individual Insurer. NBR issued a directive on the parallel run for implementation of the RBC adequacy requirements in October 2018. The parallel run period will help insurers to measure their compliance level vis-à-vis the new solvency capital adequacy requirements and provides Insurers enough time to devolop ways on how to address any gaps identified during the prescribed transition period.

Under RBC approach, the capital requirements are two folded: the Minimum capital requirements (MCR) and Prescribed Capital requirements (PCR). MCR represents the absolute minimum regulatory capital that is required to be maintained by insurers at all times. The approach sets the MCR of Insurer at a capital adequacy ratio of 100%. A ratio less than 100% would indicate that the insurer is technically insolvent and unable to cover all anticipated obligations and would not be permitted to continue operations. On the other hand, PCR represents a prescribed "supervisory minimum" capital adequacy ratio, such that Insurers falling below this level (130%) may be subject to increased regulatory interventions.

Besides, NBR is process of adopting IFRS 17 on insurance contracts, to replace the current standard IFRS 4. IFRS 17 Insurance Contracts establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the Standard. The objective of IFRS 17 is to ensure that an insurer provides relevant information that faithfully represents those contracts. This information gives a basis for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows. This standard is expected to contribute to long-term financial stability by revealing useful information about insurers that will enable actions to be taken in a timely way. From a supervisory perspective, this could be achieved if IFRS 17 is used as a valuation basis in Insurance Company's regulatory solvency control framework and this result in an earlier trigger for appropriate supervisory intervention. (Box 5 discusses in brief IFRS 17 Insurance contracts).

Private insurer's solvency ratio stood at

147% **JUNE 2021** FROM **157%** **JUNE 2020**

*Above the regulatory minimum of 100 percent

Box 5: IFRS 17 Insurance Contracts

The International Accounting Standards Board (IASB), is an independent, global accounting standard-setting body that issued International Financial Reporting Standards (IFRS) for different sectors, including insurance sector. These IFRS Standards provides a high quality, internationally recognized set of accounting standards that bring transparency, accountability and efficiency to financial markets around the world, also enabling investors and other market participants to make informed economic decisions. In May 2017, IASB Instituted the International Financial Reporting Standard for insurance contracts (IFRS 17), marking one of the most significant developments in the insurance industry in recent years. This standard for insurance companies (coming into effect by 1 January 2023) is expected to revolutionize the method of valuation and the principles of calculating profits and losses in each accounting period. Since the issuance of the standards, insurance companies worldwide have started work related to implementing IFRS 17. Many countries and regions around the world recognized and will adopt IFRS 17 to replace the current accounting standard IFRS 4.

In fact, IFRS 4 issued in March 2004, was an interim standard which was meant to be in place until the Board completed its project on insurance contracts. IFRS 4 permitted entities to use a wide variety of accounting practices for insurance contracts, reflecting national accounting requirements and variations of those requirements, subject to limited improvements and specified disclosures. These diverse requirements have instigated to difficulties of key stakeholders of insurers (investors and regulators etc.) for easy comparability the financial position of insurers in different jurisdictions. In addition, existing accounting models for insurance contracts did not provide investors with enough information to fully understand the insurer's financial position, performance and risk exposure. In May 2017, the Board completed its project on insurance contracts with the issuance of IFRS 17 Insurance Contracts. IFRS 17 replaces IFRS 4 and sets out principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of IFRS 17. The scope of this standard specifies that an entity shall apply IFRS 17 Insurance Contracts to : Insurance contracts, including reinsurance contracts, it issues; Reinsurance contracts it holds; and Investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

The objective of IFRS 17 is to ensure that an entity provides relevant information that faithfully represents those contracts. This information gives a basis for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows. IFRS 17 will bring on board the key solutions, to address gaps appearing in current standard as follows: (1) providing one accounting policy for all insurance contracts; (2) providing better comparability of insurance companies across countries; (3) providing similar accounting methods for insurance and non-insurance companies; (4) estimates will be updated each reporting period; (5) key drives of profit (investment versus underwriting results) are transparent, and (6) discount rate based on the cash flows of the contract rather than investment.

From supervisory perspective, IFRS 17 will have implication on supervisory framework established by NBR. In this context, NBR started the process of introducing the necessary legislative or regulatory changes to help in the implementation of this standard and to ensure that Insurance industry is working towards meeting the standard requirements in time. To achieve effect date of the standard by January 2023, the NBR have requested insurers to conduct self-assessment towards IFRS 17 preparedness. The self-assessment reports of Insurers are facilitating NBR to closely monitor the implementation status of this standard, considering the challenges in place to implement this standard, while finding ways to address those challenges. The impact of the new standard varies significantly between insurance companies, with a larger impact on life insurance entities. Implementing the standard requires substantial effort, including new or upgraded systems, processes and controls. The task is even more challenging given the length of contracts, therefore requiring extensive use of long-dated historical data, and dealing with the limitations of legacy systems that many still use. The NBR is expecting to put more emphasis on the leveraging and improving the existing systems, processes as prerequisite for effective implementation of the standard. For instance, existing finance systems and IT solutions will be further enhanced to cover specific accounting and reporting requirements as required by the new standard, while recommending the insurance industry to also develop actuarial capacity.

Further, IFRS 17 is expected to enhance long-term financial stability by revealing useful information about insurers that will enable actions to be taken in a timely way. This can be achieved through supervisory framework i.e. IFRS 17 can provide a valuation basis to be incorporated in a regulatory solvency control framework and this result in an earlier trigger for appropriate supervisory intervention.

The sector also held adequate liquidity buffers. Aggregate liquidity and current ratios were 238 percent and 293 percent respectively, against 100 percent minimum prudential requirement. However, private insurers' liquidity of 94 percent was below the prudential benchmark of 100 percent. The issue was more prominent in non-life insurers whose liquidity ratio stood at 81 percent in June 2021 due to the increase in premium and other receivables as well as other illiquid assets like investments in property. Life insurers' liquidity stood at 145 percent above the 100 percent prudential benchmark.

Table 8: Financial Soundness of the Insurance Sector

Description (Ratios %)	Private Insurers			Public Insurers			Insurance sector		
	Jun-19	Jun-20	Jun-21	Jun-19	Jun-20	Jun-21	Jun-19	Jun-20	Jun-21
Solvency margin (Min. 100%)	174	156	147	2297	2463	2765	1190	1228	1374
Claims ratio (max.60%)	62	62	64	52	55	49	57	59	56
Expenses ratio (max. 30%)	41	39	36	15	22	23	28	30	30
Combined ratio (max.90%)	103	101	101	66	77	72	85	89	86
ROE (Min.16%)	17	18	18	12	9	13	13	10	14
ROA (Min.4%)	5	6	6	12	9	12	10	8	10
Current Ratio (min. 120%)	76	74	81	4928	2998	3489	241	243	238
Liquidity ratio (min. 100%)	91	90	94	5305	3189	4413	268	234	293

Source: NBR, Financial Stability Directorate

The Stability of Pension Sector

The Public Pension Fund's investment mix is well diversified. 40 percent of total investments were held in equities. Domestic unquoted equities in a variety of sectors including manufacturing, banking, insurance, construction and hotels represented 49 percent of total equity investments and 20 percent of total investments. On the other hand, domestic listed equities held 23 percent of total equities and 9 percent of the Fund's investment portfolio. These have been crucial in facilitating the development of the local capital market and are across a variety of sectors including manufacturing, telecommunication and banking. Offshore equity investments represented 29 percent of total equity investments and 11 percent of total investments. 23 percent of these are held in equities listed in the region in banking and telecommunication while 77 percent are unquoted equities in banking, pharmaceuticals and technology sectors.

Bank deposits represented 19.5 percent of the investment portfolio. These deposits are diversified across all the banks in the sector. Investments in properties represented 19 percent of the Fund's investment portfolio and increased by 59 percent due to the acquisition of additional land for development across different parts of Kigali.

Table 9: Investment allocation of Public Pension Fund

Description (Billion FRW)	Jun-19	Jun-20	Jun-21	Share	%change Jun-21/20	%change Jun-20/19
Government Securities	154	185	210	18.2%	14%	20%
Equities	375	406	464	40.2%	14%	8%
Investment in properties	117	138	219	19.0%	59%	18%
Deposits in banks	155	174	225	19.5%	29%	12%
Other Investments	17	20	36	3.1%	86%	17%
Total investments	818	922	1,153	100%	25%	13%

Source: NBR, Financial Stability Directorate

The Stability of Payment Systems

The payment systems play a key role in achieving stability in a financial system. Safe and efficient payment systems promote economic and financial development and underpin financial stability by mitigating settlement risks associated with financial transactions. To support this vital role, payment systems need to be resilient so that there are no disruptions with significant financial stability repercussions to the rest of the economy. The sound and reliable systems is especially important in times of crisis during which new vectors of vulnerabilities are created. The NBR as the overseer of payment systems enhanced close monitoring of the systems, participants and instruments with the purpose of ensuring that they are adequately protected against potential risks and allowing funds to flow between individuals, business and financial markets efficiently and safely.

During the period under review, the payment systems continued to operate smoothly. The impact of COVID-19 on payments landscape was minimized by remote working policies and operational capabilities that players in payment industry had developed following the first lockdown in March 2020. In addition, the increased availability of alternative channels for delivery of financial services, including internet and mobile banking platforms, allowed financial institutions and service providers to continue serving customers with minimal interruption.

All systemically important payment systems that include the Rwanda Integrated Payments Processing Systems (RIPPS), the Central Securities Depository (CSD) and the Automated Clearing House (ACH) operated without significant disruptions during the year ended June 2021. In particular, RIPPS processed 4,093,934 transactions worth FRW 12,281.8 billion as at end June 2021 against 4,485,821 transactions worth FRW 14,785.4 billion as at June 2020, representing a decrease of 8.7 percent in volume and 16.9 percent in value. The decline of RIPPS transactions mainly reflects slowdown of economic activities due to COVID-19 crisis. The RIPPS transactions continued to be dominated by customer credit transfers accounting for 93.5 percent in volume and 62.3 percent in value. Interbank transactions and cheques clearing represented 0.2 percent and 6.3 percent volume while in value, they represented 29.5 percent and 8.2 percent respectively.

RIPPS processed transactions

4,093,934
FRW 12,281.8 Bn
End June 2021

FROM

4,485,821
FRW 14,785.4 Bn
End June 2020

Table 10: RIPPS Transactions

	June 2020 to June 2021				June 2019 to June 2020				Change	
	Volume	Value FRW 'M	Share of volume	Share of value	Volume	Value FRW 'M	Share of volume	Share of value	% volume	% value
Customer credit transfers	3,829,131	7,650,920	94%	62%	4,208,000	6,510,882	94%	44%	-9%	18%
Interbank transactions	6,530	3,620,066	0%	29%	7,336	7,321,594	0%	50%	-11%	-51%
Cheques	258,273	1,010,845	6%	8%	270,485	952,967	6%	6%	-5%	6%
Total	**4,093,934**	**12,281,831**	**100%**	**100%**	**4,485,821**	**14,785,443**	**100%**	**100%**	-9%	-17%

Source: NBR, Financial Stability Directorate

In face of COVID-19 pandemic, the focus continued to be centered on enhancing cyber and operational resilience of the wholesale and retail payment systems. The NBR, regulated financial institutions and service providers deployed effective control and made all necessary arrangements to ensure business continuity, particularly from a service delivery perspective. Such arrangements included employees operating from home, assessments and prioritization of critical processes, working and providing services through digital means. In this regard, the NBR continues to encourage institutions to innovate, promote and leverage electronic banking and payment channels in a prudent manner that minimizes the occurrence of risks at the same time promotes financial sector deepening. Furthermore, to improve efficiency in payment industry, the NBR continued coordinating the implementation of innovative payment projects to shift payment system to real time/instant mode for both large value payment system and retail payment. The ongoing RIPPS upgrade is expected to enhance mitigation of operational risks inherent in payment systems and at same time promotes usage of digital banking and payment.

In retail payment, the use of digital payment and banking has continued to gain traction during the period of COVID-19 pandemic. As movements were restricted either by lockdowns or curfews as well as capacity limitations in physical banking premises financial service providers, businesses and individuals had to adopt in order to make and accept payments. The waiver of fees on some services, notably mobile merchant payments has also contributed to the adoption of these payment channels further enabled by the roll out of payment touch points and on boarding of subscribers and merchants.

Developments in payment systems continued to pick-up mainly driven by mobile financial services. The number of active mobile payments subscribers increased by 25 per cent from 4.9 million in June 2020 to 6.1 million in June 2021, while the number of agents increased by 29 per cent from 111,422 in June 2020 to 144,250 in June 2021. The number of mobile payment transactions increased by 42 per cent from 299,013,452 in June 2020 to 424,792,238 in in June 2021, while the value of transactions increased by 100 per cent from FRW 2,580 to 5,169 billion. On the other hands, the number of banks that provide mobile banking remained unchanged as 11, but the number of mobile banking subscribers increased by 11 per cent from 1,882,168 in June 2020 to 2,080,549 in June 2021. Similarly, the number of transactions increased by 13 per cent from 2,604,052 in June 2020 to 2,951,186 in JUNE 2021 while the value of transactions increased by 98 per cent from FRW 105.8 to 209.8 billion.

Internet banking also continued to grow during 2021. Internet banking subscribers increased by 21 per cent from 87,614 in June 2020 to 106,312 in June 2021, the number of transactions by 15 per cent from 712,430 in in June 2020 to 819,336 in June 2021 and the value of transactions by 24 per cent from FRW 1,295 in June 2020 to 1,605 billion in 2021. 9 banks provided internet-banking services.

21%

Internet banking subscribers

106,312 JUNE 2021 FROM **87,614** JUNE 2020

Table 11: The use of various cashless payment instruments

Period	Jun-2021			Jun-2020		
Instrument	Subscribers	Transactions		Subscribers Volume	Transactions	
		Volume	Value M/ FRW		Volume	Value M/ FRW
Cards	657,477	8,938,646	611,120	488,399	5,382,771	307,270
Mobile banking	2,080,549	2,951,186	209,882	1,882,168	2,604,052	105,865
Mobile payment	6,129,624	424,792,238	5,169,962	4,915,320	299,013,452	2,580,948
Internet banking	106,312	819336	1,605,708	87,614	712,430	1,295,610

Source: NBR, Financial Stability Directorate

Mobile POS recorded significant usage compared to other types of POS during the period under review. Modern Points-of-Sale include Mobile POS (USSD based) and Virtual POS (QR Code based). The number of mobile POS increased to 45,627, in June 2021 from 33,341 in 2020 due to the businesses acceptance of mobile payments such as supermarkets, retail shops, health centers and microbusinesses. Mobile POS transactions increased significantly by 627 percent in volume from 6 million to 45 million, while in value increased by 705 percent from FRW 115 billion to FRW 925 billion due to various policies taken including free merchant services, intensive awareness campaign and merchants' on boarding to encourage digital payment. On the other hand, virtual POS and near field communication (NFC) POS decreased during the period under review. The number of virtual POS decreased from 4,437 in June 2020 to 4,280 in June 2021 while Mobile POS replaced NFC POS due to low adoption by merchants. The virtual POS transactions decreased in volume by 70 percent from 2,956 to 893 while they decreased in value by 83 percent from FRW 29 million to FRW 5 million due to the fact that the virtual POS is not yet interoperable which resulted in low adoption.

The volume Card based transactions also continued to grow. The number of traditional Point of Sale (POS) machines increased from 3,929 in June 2020 to 4,635 in June 2021. POS transactions increased by 80 percent in volume from 1,524,908 in June 2020 to 2,752,070 in June 2021, while in value they increased by 107 percent from FRW 47 billion in June 2020 to FRW 98 billion in June 2021. The increase of POS transactions was due to increased deployment of POS devices and adoption of cashless means of payment which contributes in an increase of economic growth in general. Automated Teller Machines (ATM) increased from 331 in June 2020 to 338 in June 2021. In terms of usage, ATM transactions increased by 60 percent in volume from 3,857,863 in June 2020 to 6,186,576 in June 2021 while the value increased by 97 percent in value from FRW 260 billion to FRW 513 billion.

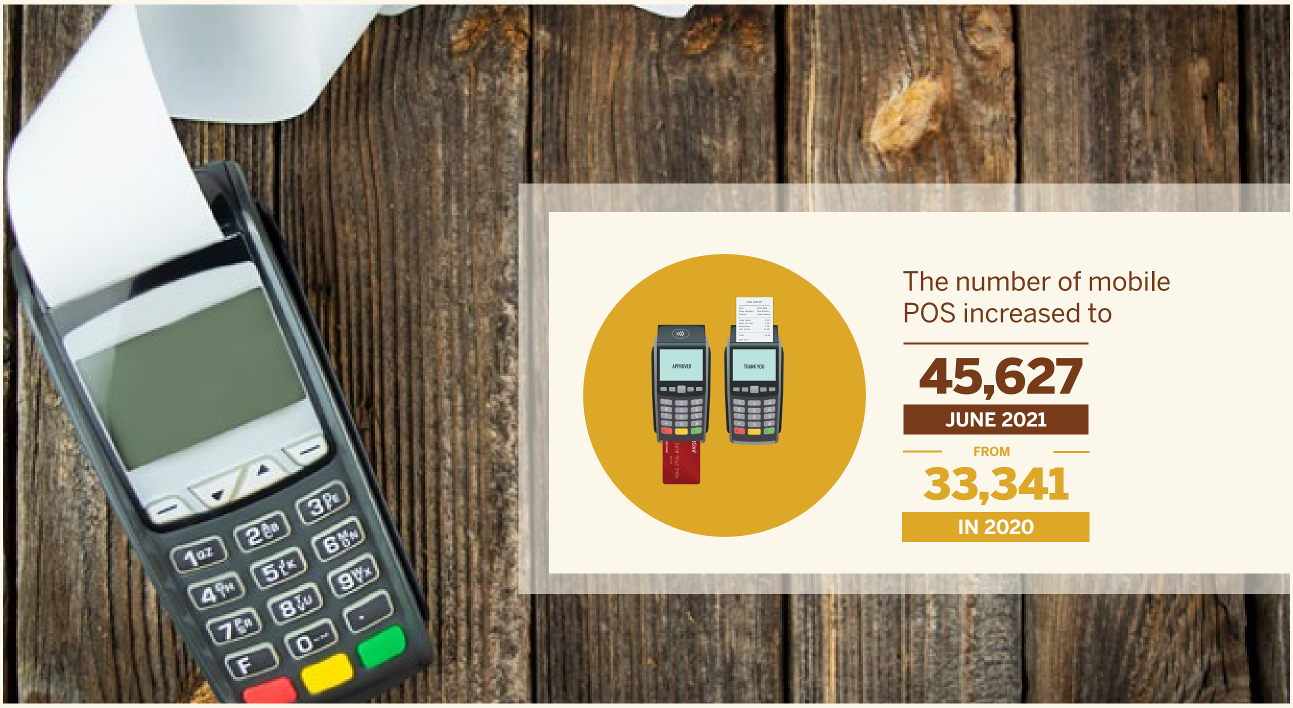
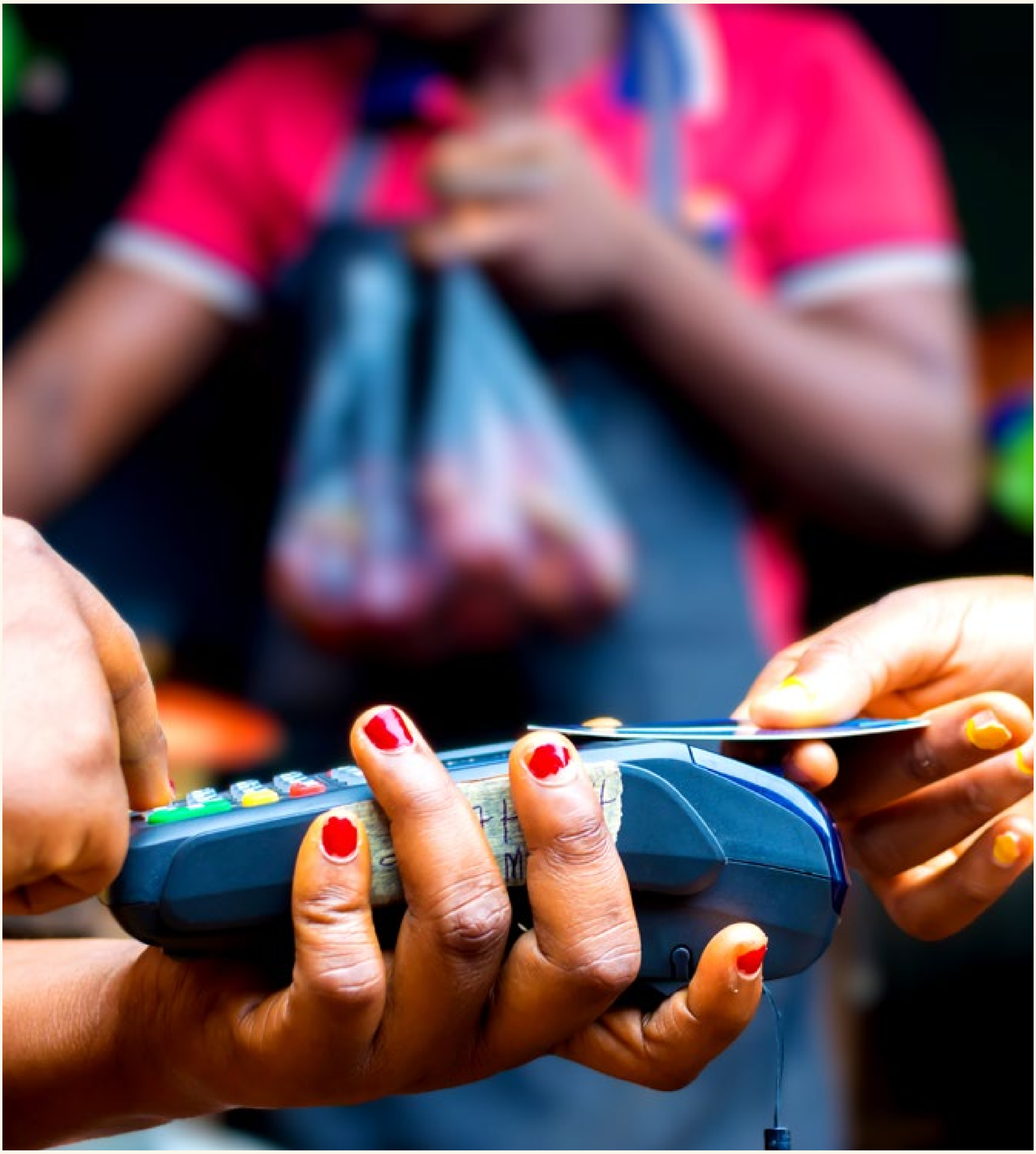


Table 12: Development of Payment Access Points

Number of Payment Access Points	Jun-17	Jun-18	Jun-19	June 2020	June 2021
ATM	405	382	390	331	338
Traditional POS	2,031	2,198	3,046	3,929	4,635
Modern POS	-	12,959	17,048	37,829	62,838

Source: NBR, Financial Stability Directorate



Emerging risks: crypto currencies and the need for central bank digital currency

The use of cryptocurrencies in performing online transactions has been on the rise globally, and gaining traction with investors for many reasons, including its non-traditional structure and potential for significant returns on investments. However, their increasing significance in the global economy has attracted the attention of Central Banks globally. A cryptocurrency is a digital or virtual currency/money that uses cryptography, a process of changing legible information into a code, making it impossible to track any transfers or purchases . Cryptocurrencies use block chain technology, which uses encryption techniques to control the creation of monetary units and to verify the transfer of funds without a need for a central clearing authority. In some advanced countries, cryptocurrencies are gradually being recognized as both a method of payment and store of value. This technology that supports crypto currency is evolving and will also likely turnaround how the financial services operate. Cryptocurrencies have mostly been a phenomenon of advanced economies, and also are spreading and growing in third world countries (South America, Asia and Africa) . In East Africa Bitpesa founded in 2013, a Kenyan based blockchain payments platform is operating across Uganda, Kenya, Tanzania, and DRC, integrating with banks and mobile money. Cryptocurrencies are also gaining popularity in differently countries, and reflects that this trend will likely emerge across Africa.

Among the benefits of virtual currencies are greater speed and efficiency in making payments and transfers. According to the IMF, the block chain technology underlying most virtual currency schemes - an innovative decentralized means of keeping track of transactions in a large network - offers potential benefits that go far beyond virtual currencies themselves. Ventures capitalists and financial institutions are taking interest and heavily investing in block chain technology projects. Despite the benefits however, the risks posed by cryptocurrencies seem to be greater.

First, this area is less understood around the world and this makes it alien to regulators. Given that cryptocurrencies are growing in popularity as the new technologies become widely used, the lack of regulatory oversight may exacerbate the risks cryptocurrencies pose to financial stability. The Global Financial Stability report of October 2021, provides a number of risk transmission channels of crypto assets, though are not yet posing a material risk to global financial stability, include risks from the size of market capitalization, investor confidence effects, risks arising from direct and indirect exposures of financial institutions, and risks from the use of crypto assets for payments and settlements. In some advanced economies, market capitalization has grown by a factor of 10 and is now comparable to some established asset classes (for example US high-yield bonds). It is still small, however, compared with government bond and stock markets in major advanced economies. Loss of confidence in crypto assets so far have had limited spillovers to broader markets despite large fluctuations in crypto asset valuations. Confidence effects from failures of crypto asset providers have also been limited so far. However, their importance is rising as trading volumes in some countries' exchanges have increased dramatically and, in some cases, are comparable to the volumes of their respective domestic stock exchanges. Exposures to crypto assets in the banking system are growing, albeit from a low base. Exposures appear to be growing faster among some non-bank institutions, most notably hedge funds, which can lead to increased indirect exposures of the banking system. The use of crypto assets for payments and settlements is to some extent still limited. This channel can accelerate rapidly, given that several global payment companies have only recently started to integrate with the crypto ecosystem, in particular with stablecoins . At a global level, financial stability risks appear contained for now, but the macro-criticality of crypto assets, and in particular stablecoins, can be significantly higher for some emerging market and developing economies where adoption has progressed fast. There are also challenges posed by the crypto ecosystem as its rapid growth has been accompanied by the entrance of new entities, some of which present operational risks, cyber risks, and governance risks. Operational risks can result in significant downtime when failures and disruptions prevent the use of services and even result in large losses of customer funds. Cyber risks include high-profile cases of hacking-related thefts of customer funds. Governance risks involve the lack of transparency around issuance and distribution of crypto assets and have resulted in investor losses.

Regulation is a major concern with cryptocurrencies. The emergence of cryptocurrencies has been a disruption for the government regulatory systems across the globe. Governments have tight regulations and control over traditional banking systems, which is not currently the case for the cryptocurrency framework. It has however been noted that the success of cryptocurrencies will depend on the way the regulatory framework works. In addition, given the rise in interest and adoption of digital transactions and payment systems in almost every sector, and with cryptocurrencies gaining recognition worldwide, governments have, as well, expressed interest in developing policies and regulations that will allow this innovative currency to expand. This would not only satisfy the privacy of the transactions but also allow government regulatory systems to mitigate the risks that come with the technology.

Bank for International Settlements (BIS), the global standard setting body for central banks, started urging central banks globally to join their efforts and achieve "interoperability" between their digital currency projects. This can be achieved through a number of ways, such as creating common standards and establishing international payment infrastructures. Several central banks are exploring digital currencies which would be issued by central banks to commercial banks or directly to the public. Their efforts have intensified over the past year amid a decline in cash usage and growing interest in cryptocurrencies. Some Central Banks around the world are waking up to the call by experimenting with their own cryptocurrencies. Recently, BIS has given its full backing to the development of central bank digital currencies (CBDCs) to modernize finance and ensuring these technological innovations do not take control of money. Because cryptocurrencies are circumventing the established money system, and if they continue gaining popularity and be widely used, they may render this current system outdated, and so complicate the conduct of monetary policy.

After the Bahamas became the first to launch a general purpose CBDC, known as the Sand Dollar, many countries have started to test the use of CBDC especially in Australia, Malaysia, Singapore and South Africa in an experiment that could lead to a more efficient global payments platform. Also countries like China has a number of ongoing trials and Switzerland and the Bank of France have announced Europe's first cross-border experiment. Although Cryptocurrencies are not yet an issue for Rwanda, the pace at which they are growing shows that this trend will start to emerge. In Kenya, the Central Bank has been struggling with how to regulate BitPesa given the complexity of the platform and its implication to policy. As Rwanda's tech sector continues to grow, we will likely see the evolution of cryptocurrencies. It is against background that NBR commissioned a study around CBDC in response to global trends in digital currency. This study is looking at economic, financial and technology aspects related to CBDC as well as the operationalization model, taking into account the local context, and the implication monetary policy and financial stability.

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