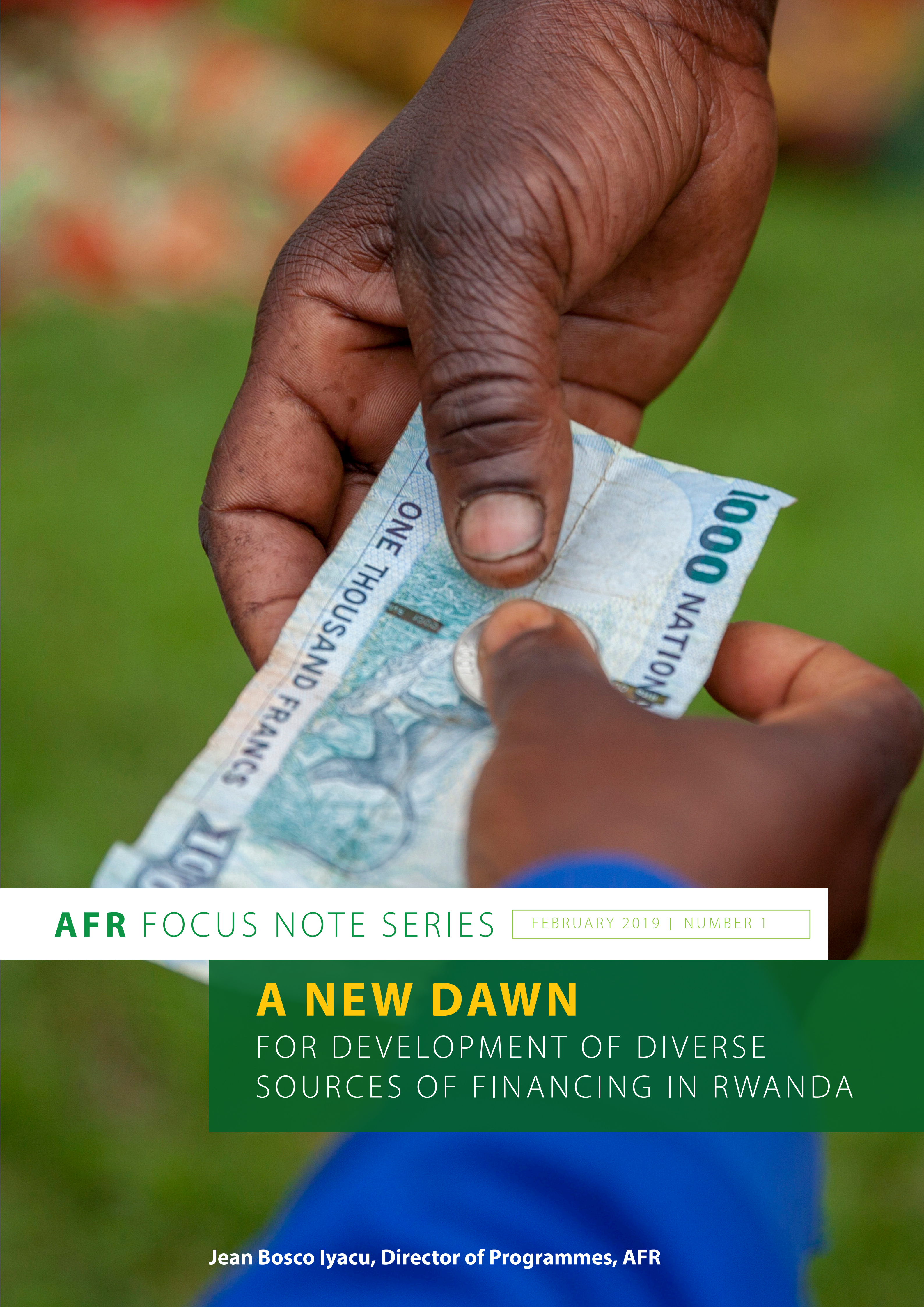

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A NEW DAWN
FOR DEVELOPMENT OF DIVERSE SOURCES OF FINANCING IN RWANDA

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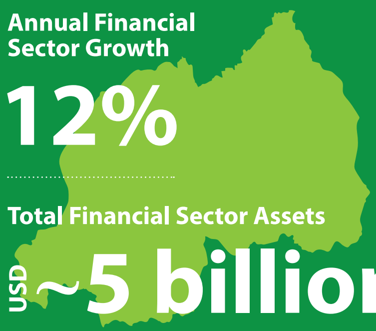
Introduction

The law regulating non-deposit taking lending institutions was published on 17th December 2018, offering a great start to the new year as it encourages the entire financial sector to embrace and foster innovation to serve the underserved market.

This focus note examines what the new law means for the sector in Rwanda and how it could stimulate the role of non-banking financial service providers in the provision of credit intermediation outside of the regular banking system.



Annual Financial Sector Growth

12%

Total Financial Sector Assets

USD ~5 billion

Source: As of 30th June 2018. Annual Financial Stability Report 2017/2018, National Bank of Rwanda (BNR)

The banking sector remains the largest sub-component of Rwanda's financial sector

owning 66% of the total financial sector assets

However, it serves only 26% of the adult Rwandan population

Source: 2016 Finscope survey

During the last two decades, we have witnessed new developments in the financial sector across the globe. Myriads of firms have disrupted the market by offering financial products and services through a wide range of distribution channels. These parallel financial institutions are functionally very similar to traditional financial service providers – yet they are barely supervised or regulated. Some of them do not hold any capital for security reasons and are not subject to any meaningful prudential requirements regarding liquidity, leverage or any other feature of their assets and liabilities. They also have very few reporting obligations and governance standard requirements.

These institutions operate within a framework commonly referred to as **'shadow banking',** a system which the Financial Stability Board broadly defines as *"credit intermediation involving entities and activities (fully or partially) outside the regular banking system or call it non-bank credit intermediation."* The shadow banking sector contains all financial institutions that perform bank-like activities but are not subjected to the same regulatory requirements as banks and do not have access to public safety nets.

The importance of shadow banking and its current regulatory landscape

"The shadow banking system has a tangible reputation of providing market participants with an alternative source of funding and liquidity with more flexibility. However, as the 2008 financial crisis has shown, the shadow banking system can also become a source of systematic risk, both directly and through its interconnectedness with the regular banking system. It can also create opportunities for arbitrage that might undermine stricter bank regulation and lead to a build-up of additional leverage and risk in the system."

FSB , 2011, p. 1

The Alliance for Financial Inclusion (AFI) conference held in Moscow in 2015 emphasised the importance of shadow banking. Firstly, it highlighted the importance of non-bank financial intermediaries in driving innovation and channelling funds for financial inclusion and economic growth, especially in emerging economies and developing countries. Secondly, it supported the efforts of regulators and supervisors to identify and monitor trends in shadow banking and advance proportionate regulations to address the risks to financial stability emerging outside the regular banking system. The rationale for regulating shadow banking lies in its potential impact to the overall systemic risk within the financial system and like other segments of the financial intermediation, shadow banking regulation has to be designed to protect customers and, more generally, less informed parties.

As a result of this conference's deliberations and following the Financial Stability Board's recommendation to central banks to monitor shadow, China and the European Union (with a critical role of the United Kingdom), started devising regulatory frameworks of shadow banking. Africa followed suit and more than seven countries including Tanzania, Kenya, Gambia, Ghana, Liberia, Uganda and South Africa have introduced shadow banking regulations.

African countries with shadow banking regulatory frameworks

Shadow banking in Rwanda

SHADOW BANKING OPPORTUNITIES AND RISKS

Shadow banking may contribute to driving innovation and channelling funding for increased financial inclusion

The non-oversight of the shadow banking system can be a source of systemic risk when there is interconnectedness with the regular banking system

The Rwandan economy and the financial sector are growing fast. To stimulate continued financial growth and innovation, there is a need of a progressive and uniform regulatory framework to which prescribes multiple and diverse sources of finance for economic agents. It is therefore advisable to allow new products to the market by following a sandbox regulatory framework that supports a "Test, Learn and Regulate" approach for both the innovator and the regulatory body.

From April to May 2018, Access to Finance Rwanda (AFR) in collaboration with the National Bank of Rwanda (BNR), carried out a survey to assess the shadow banking system and related activities in Rwanda in order to advise on how to design a conducive regulatory environment for entities involved and put in place a supervisory mechanism that will help them optimise their operations.

The survey provided evidence of a shadow banking system in Rwanda as it identified more than seven entities with shadow banking characteristics. Those are credit only institutions, guarantee providers, peer to peer lending platforms, cloud funding, factoring companies, private equity funds, etc.

As a result of these findings, the National Bank of Rwanda, with support from AFR, published a new regulation for non-deposit taking lending Financial Institutions on the 17th December 2018.

See link: http://afr.rw/IMG/pdf/regulation_no_2100__2018_-_00011_614_of_12_12_2018_of_the_national_bank_of_rwanda_governing_non_deposit_taking_lending_financial_institutions.pdf

What should we expect from the new regulatory framework?

"BeneFactors Ltd welcomes the new licensing structure. It provides much needed clarity and regulatory predictability for non-deposit-taking financial institutions and it provides comfort for our investors. We remain committed to work with the regulator to promote innovation in the sector and we are looking forward to further developments of the same nature".

Olivia B Zank,
CEO & Founder of BeneFactors Ltd, a factoring firm

The new regulation is expected to allow the provision of responsible credit finance only, mortgage finance, credit guarantees, refinancing, factoring, debt collection and other financial services.

An essential feature of the regulation is that it will enable non-banking financial service providers with an innovative product or service that does not correspond to one of the regulated services or products to apply for a 'sandbox' at the central bank. A sandbox is a live, contained environment in which participants can test their product, service or solution subject to the requirements under a regulatory body.