September 2005
IMF Country Report No. 05/309

Rwanda: Financial System Stability Assessment, including Reports on the Observance of Standards and Codes on the following topics: Monetary and Financial Policy Transparency, Banking Supervision, and the FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism

This Financial System Stability Assessment on Rwanda was prepared by a staff team of the International Monetary Fund and the World Bank as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on August 19, 2005. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Rwanda or the Executive Board of the IMF.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

RWANDA

Financial System Stability Assessment

Prepared by the Monetary and Financial Systems and African Departments

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August 19, 2005

The Financial System Stability Assessment is based on the work of a joint IMF-World Bank FSAP mission that visited Rwanda in February 2005. The team comprised Ann Rennie (chief, World Bank), Bernard J. Laurens (deputy chief, MFD), Amadou Sy and Sandra Marcelino (both MFD), Krzysztof Bledowski (AFR), Didier Debals (Banque de France), Samira Ghribi (Banque Centrale de Tunisie), Charlie Garrigues (consultant), Koro Ouattara, Guillemette Jaffrin, Eric Haythorne, Pauline Aranda, Olivier Hassler, Fatou Assah, and Fatiha Amar (all World Bank). The assessment of the AML/CFT regime was carried out by a separate World Bank team led by Emile van der Does de Willebois, and comprising Boudewijn Verhelst (law enforcement expert, Belgian Financial Intelligence Processing Unit), and Richard Gordon (financial expert, consultant).

Rwanda's economy has made considerable progress in overcoming the devastating consequences of the 1994 genocide, but economic performance is vulnerable to shocks, in particular a sharp fall in aid flows. The domestic financial sector still faces a poor environment with economic activity concentrated in a few sectors and a weak credit culture. There are serious shortcomings in the accounting and auditing systems and the institutional, legal, and judicial frameworks. The program of recapitalization and privatization started after 1994 has strengthened the short-term resilience of banks but structural weaknesses remain. Banks would have difficulties coping with the second order effects from a prolonged decline in aid flows and are heavily exposed to a few large borrowers. The domestic financial system remains shallow, especially outside the banking sector, and access to credit remains limited apart from a network of savings and loans cooperatives.

The National Bank of Rwanda (NBR) has restored all of its basic functions, but faces formidable challenges. As the main regulator and supervisor of the financial sector, NBR's key challenge has to do with the weak environment for effective supervision, instances of regulatory forbearance, and a shortage of human capital that has been compounded by weak internal governance in some financial institutions. Most notably, there is a need to: (i) enhance further NBR's autonomy and supervisory powers; (ii) upgrade the accounting, auditing and payment systems, and the legal framework; (iii) deepen the money and foreign exchange markets; and (iv) develop an AML/CFT framework beginning with the enactment of a comprehensive AML/CFT law.

The formidable challenges to capacity building in the financial sector will require unwavering commitment to financial sector reforms on the part of the authorities, as well as continued support by external providers of technical assistance. The authorities plan to coordinate technical assistance by organizing a meeting to identify key donors in the various involved sectors.

FSSAs are designed to assess the stability and performance of the financial system as a whole and not that of individual institutions. FSSAs do not cover risks that are specific to individual institutions such as asset quality, operational or legal risks, or fraud.

This report was prepared by Bernard J. Laurens and Amadou Sy.

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Glossary

AML	Anti money laundering
BCP	Basel Core Principles for Effective Banking Supervision
BRD	Banque Rwandaise de Développement
CAR	Capital Adequacy Ratio
CDD	Customer Due Diligence
CFT	Combating of the Financing of Terrorism
CHR	Caisse Hypothécaire du Rwanda
CNCA	Commission Nationale de Contrôle des Assurances
CP	Core Principle
DNFBP	Designated Non-Financial Business and Profession
FATF	Financial Action Task Force
FSAP	Financial Sector Assessment Program
FSSA	Financial Sector Stability Assessment
GDP	Gross Domestic Product
MFIs	Microfinance institutions
MFD	Monetary and Financial Systems Department
MFPT	Monetary and Financial Policies Transparency
MINECOFIN	Ministère des Finances et de la Planification Économique
MIS	Management Information Systems
MFPT	Monetary and Financial Policies Transparency
ML	Money Laundering
NBR	National Bank of Rwanda
NPLs	Nonperforming Loans
PRSP	Poverty Reduction Strategy
ROSC	Report on Standards and Codes
SFIs	Specialized financial institutions
SMEs	Small and Medium Enterprises
TF	Terrorism Financing
UBPR	Union des Banques Populaires

I. Overall Assessment of Stability and Development Issues

1. **The Rwandese economy has recovered considerably since the 1994 genocide but is still vulnerable to exogenous shocks.** In spite of improved macroeconomic performance over the past decade, the economy is still challenged by a high external debt burden, vulnerability to terms of trade shocks, and one of the lowest saving rates in Africa, at 3 percent of GDP. As a consequence, the economy is relying heavily on foreign currency denominated aid inflows.

2. **The domestic financial sector faces a weak environment**. Economic activity is concentrated in a few sectors and credit culture is weak. Normalized accounting standards and appropriate auditing rules for the nonfinancial sector are lacking. There are limitations in the legal and judicial frameworks and corporate governance, including in some commercial banks, is weak. In addition, there is a lack of human capital in the financial sector as well as in the accounting and auditing profession.

3. **Privatizations and recapitalizations have strengthened the short term resilience of banks but the system remains vulnerable to shocks, in particular a sharp decline in aid flows.** Five financial institutions out of the nine in operation in Rwanda have been recapitalized recently, two of which have been privatized. Financial soundness indicators have improved markedly, and supervision has been upgraded. However, asset quality remains weak; the structure of the economy results in risk concentration; and governance problems in some banks have generated vulnerabilities. Stress tests indicate that banks would have difficulties coping with the second order effects from a prolonged decline in foreign aid inflows. Given the structure and activity of banks, credit risk is the main source of vulnerability as banks are highly exposed to a few large borrowers.

4. **The domestic financial system remains shallow.** Financial depth (assets worth 34 percent of GDP and M2 equal to 17 percent of GDP) is well below the sub-Saharan average. Most banking transactions take place in Kigali and loans go mainly to a small number of corporations operating in trade, tourism, property development, and manufacturing. In contrast, agriculture, by far the largest sector of the economy, received only 2 percent of direct bank credit in 2003.

5. **Access to credit and financial services benefits from the rehabilitation of a network of savings and loan cooperatives, but the other segments of the financial sector are underdeveloped.** Over 30 percent of households have an account in a financial institution, which compares favorably to countries at similar levels of development. However, insurance penetration is low, and to date the sector has been unregulated and unsupervised. Pensions are largely restricted to a public system which provides coverage to a limited segment of the population, has large arrears in contributions from the public sector, and is likely to be unsustainable over the longer term unless fundamental reforms are undertaken. The securities market is limited to the issuance of short-term treasury bills.

6. **The National Bank of Rwanda (NBR) has restored all of its basic functions, but faces formidable challenges.** It has developed a sound liquidity management framework, but the size and variability of aid flows, and NBR's dominant position in the foreign exchange market calls for skillful liquidity management on a continuous basis. The NBR has also upgraded its capacity to supervise commercial banks and specialized financial institutions, but challenges remain due to the weak environment for effective supervision, and a shortage of human capital.

7. **Maintaining the stability, and increasing the reach and efficiency of the financial sector calls for a strengthening of the institutional framework and market infrastructure**. Most notably, there is a need to enhance further the NBR's autonomy and supervisory powers and later establish a capacity to effectively supervise the insurance sector. The legal, accounting, auditing and payment systems also need to be upgraded. Further development of money and foreign exchange markets needs to be facilitated and an AML/CFT framework needs to be developed, beginning with the enactment of a comprehensive law.

8. **Since the completion of the FSAP field work, the authorities have moved forcefully in a number of areas**. Box 1 summarizes the key recommended actions, and identifies those which have already been implemented. The formidable challenges to capacity building in the financial sector will require unwavering commitment to financial sector reforms on the part of the authorities, as well as continued support by external providers of technical assistance in the following areas: monetary policy design and implementation; financial sector supervision (including commercial banks, microfinance and nonbank financial institutions); capacity development in the microfinance sector; payment systems modernization; capital market development; upgrading the legal and judicial framework, and likewise the accounting and auditing framework. The authorities plan to organize a meeting by March 2006 to identify key donors for the various sectors involved, and coordinate their assistance.

Box 1. Key Recommended Actions

Immediate and Near-Term Measures

Institutional, legal and judicial frameworks

- Establish a Law Reform Committee to prioritize/coordinate a review of financial legislation.
- Revise the NBR law to allow greater NBR autonomy, including setting explicit criteria for removal of members of its governing bodies.
- Finalize plans for commercial chambers of provincial Courts and Kigali Trial Court.
- Improve land registration.

Box 1. Key Recommended Actions (Continued)

Financial regulation and supervision

- Specify scope for corrective measures on delinquent banks and implementation modalities.
- Introduce regulation on banks' governance, and strengthen limits on connected lending.
- Encourage loan syndication to help reduce individual bank risk concentration.
- Establish an effective capacity to regulate and supervise the insurance sector.

Accounting, auditing and payment systems

- Reactivate the National Payment Council to coordinate all payment systems initiatives.
- Draft accounting and auditing standards.

Systemic liquidity and foreign exchange market and operations

- Promote the foreign exchange market and hedging possibilities, including through allowing forward contracts, and lending in foreign exchange to pre-finance exports.*
- Strengthen NBR interest rate management and facilitate money market development, by establishing a corridor for interbank market rates, and adopt a market-based interest rate as NBR policy rate.*

Medium-Term Measures

Institutional, legal and judicial framework

- Provide continuing training of specialized magistrates in commercial and financial matters.
- Set up a registration-based pledge system allowing debtors to possess/use movable collateral.
- Develop an AML/CFT framework beginning with the enactment of an AML/CFT law.

Financial regulation and supervision

- Prepare an action plan to address additional weaknesses identified in the BCP assessment..
- Expand NBR's resources for financial regulation and supervision.
- Develop investment guidelines for the insurance sector.

Monetary framework and systemic liquidity

- Develop research at NBR on monetary policy transmission channels.

Capital market development

- Develop cost effective solutions to address the lack of long-term savings and credit, such as leasing.

1/ These measures have already been implemented.

II. Stability and Supervisory Issues in the Banking Sector

A. Macroeconomic Risks Affecting the Financial Sector

9. **Rwanda's economy has made considerable progress in overcoming the consequences of the genocide, but economic performance remains vulnerable to shocks**. The low domestic saving ratio (at 3 percent of GDP, one of the lowest in Africa) makes Rwanda highly dependent on official aid inflows to finance the budget and on terms of trade shocks. Consequently, the NBR is expected to remain a key player in the foreign exchange market, and skillful liquidity management by the NBR is critical to mitigate the shocks that may result from the impact of aid inflows as well as the day-to-day variability of these inflows. Furthermore, the authorities will have to manage potentially large donor inflows, which may result in real exchange rate appreciation.

Table 1. Selected Economic Indicators

	2000	2001	2002	2003	2004
Real Sector		*(Annual percentage change)*			
Real GDP	6.0	6.7	9.4	0.9	4.0
Inflation rate (end of period)	3.9	3.4	2.0	7.4	10.2
Monetary and Credit Data		*(Annual percentage change)*			
Money (M1)	6.7	1.0	10.4	17.0	n.a.
Broad money (M2)	14.3	9.2	11.4	15.2	12.6
Domestic credit	0.7	0.4	-5.4	31.8	-22.6
Reserve money	-6.6	6.6	11.9	12.2	13.4
NBR money market borrowing rate	9.9	9.5	10.5	11.6	10.6
Government Finance		*(In percent of GDP)*			
Domestic fiscal balance	-2.6	-2.7	-4.2	-5.5	-5.6
Overall deficit, excluding grants	-8.9	-9.5	-8.9	-10.3	-12.2
Overall deficit, including grants	0.7	-1.3	-1.7	-2.3	-0.2
Arrears repayment	0.2	-4.2	-0.2	-1.5	-1.6
External financing (net)	1.6	5.4	3.7	2.1	4.5
Domestic financing (including errors and omissions)	-2.5	0.1	-1.7	1.6	-2.8
Balance of Payments		*(In millions of U.S. dollars)*			
Trade balance	-150.1	-144.4	-167.4	-181.0	-177.0
Services (net)	-141.4	-125.3	-125.1	-143.4	-156.2
Private current transfers (net)	11.0	21.7	24.5	31.3	35.1
Official current transfers (net)	205.6	170.1	170.3	192.5	278.0
Current account balance (incl. official transfers)	-90.2	-100.3	-116.7	-131.1	-54.2
Gross official reserves (end of period)	190.6	212.1	243.6	217.6	314.5
Reserve cover (months of imports)	5.4	6.0	6.3	5.0	5.8
Balance of Payments and National Accounts		*(In percent of GDP)*			
National savings (excluding official transfers)	1.0	2.5	0.3	-0.8	2.4
Current account balance (excl. official transfers)	-16.3	-15.9	-16.6	-19.2	-18.1
Exchange rate RF per U.S. dollar (end of period)	430.3	455.8	511.9	571.4	566.9

Source: Rwandese authorities and staff estimates.

10. **Although Rwanda reached the HIPC completion point in 2005, external debt could again rise to unsustainable levels, creating a source of vulnerability to the financial system.** Even with the topping up under the completion point, Rwanda's external debt situation is projected to temporarily worsen with the NPV of debt-to-exports ratio projected to rise from 150 percent in 2003 to 200 percent in 2007.[1] Only thereafter is the ratio projected to gradually fall to 150 percent in 2014 and remain around this level in the following years. However, this scenario presented in the completion point document hinges on Rwanda receiving 83 percent of its financing in the form of grants and the remainder in concessional loans on standard IDA terms.

B. Structure and Performance of the Financial System

11. **Rwanda's financial system is shallow and dominated by a small number of banks.** Measured in terms of system's total assets or broad money to GDP, financial sector depth is low (Table 2). The provision of financial services other than by the six commercial banks is limited, with the exception of a credit cooperative network (Union de Banques Populaires-UBPR). Other specialized financial institutions (SFIs) include a state-owned development bank (BRD) and a mortgage bank (CHR).

12. **Credit to the economy remains concentrated in Kigali and to a small number of sectors.** Loans go mainly into trade, tourism, property development, and manufacturing. Agriculture, by far the largest sector of the economy, received only 2 percent of direct bank credit in 2003, although it benefits from indirect credit from intermediaries. Maturities tend to be short, generally not exceeding three months for deposits and one year for loans.

Table 2. Structure of the Financial Sector

	Assets		Percent of Assets		Percent of GDP	
(FR billions)	2000	2004	2000	2004	2000	2004
Banks	121.6	192.2	58.7	53.0	17.2	18.1
SFIs	20.8	63.5	10.0	17.5	2.9	6.0
of which UBPR	11.4	36.1	5.5	10.0	1.6	3.4
Insurance 1/	11.7	*15.7*	5.7	*4.3*	1.7	*1.7*
MFIs 2/	--	16.2	--	4.5	--	1.5
Pension	53.0	*74.8*	25.6	20.7	7.5	*8.3*
Total	207.1	362.4	100.0	100.0	29.3	34.2
Memorandum items						
M2			55.1	50.7	16.2	17.3
Private sector claims			37.0	29.7	10.9	10.1
Claims on government			24.9	16.4	7.3	5.6

Sources: National Bank of Rwanda and staff estimates.

1/ In italics are data as of 2003.

2/ Data available on three MFIs only.

13. **The nonbank financial sector is small**. The insurance sector is very small, with four companies (one state-owned and three private). The pension system is restricted to a public pay-as-you-go system which provides mandatory coverage to public and private sector workers in the formal sector. Housing finance is limited due to lack of long-term lending, the

[1] See IMF Country Report No. 05/173.

level of interest rates, some market distortions and the legacy of a real estate bubble, which contributed to CHR insolvency. UBPR is an important provider of microfinance services, and the remainder of the industry is relatively recent, though growing rapidly.

14. **The privatization of two commercial banks has brought to completion the restructuring of the banks that was launched in the aftermath of the genocide**. Currently, the three largest banks control about two-thirds of total system assets. Weighted by total assets, the government controls about 22 percent of the sector after the privatizations, down from 45 percent at end-2003. The restructuring of the BRD was completed in 2003, and the CHR was recapitalized with the proceeds of the sale of government-owned houses and with public sector debt cancellations.

15. **Notwithstanding its shallowness, the penetration of the financial sector compares favorably to countries at similar levels of development**. It is estimated that approximately 15 percent of the active population has an account in a financial institution, which translates into a household access rate of over 30 percent. Virtually all of the banks compete across the spectrum for market segments which can be categorized as large corporations and established SMEs, and consumer clientele consisting of urban salaried workers. The core group of bank customers is made of about 50 corporate customers which, in addition to a few private firms and large public sector entities, comprise NGOs, consulates, embassies, and international organizations. Financial institutions offer basic savings and credit products, but even unsophisticated products such as leasing are absent.

16. **The profitability and efficiency of the banks and SFIs bounced back in 2003 and 2004, suggesting that the system has overcome the shocks of the 1990s**. While the SFIs and the commercial banks operate under different constraints, both groups exhibit similar average return on their earning assets in domestic currency, with lower funding costs at some banks not passed on to borrowers (Table 3). This situation points to the oligopolistic nature of the financial system (i.e., strong banks benefit from the constraints faced by weak banks).[2] On average, gross interest margins on earning assets are high, reflecting the predominance of noninterest bearing demand deposits in the sources of funding, and relatively high interest rates on lending. Provisioning for NPLs absorb about a quarter of the gross interest margin.

Table 3. Margins on Total Earning Assets

(Year 2004)	Banks	SFIs
Total earning assets (TEA) 1/	**102.1**	**47.6**
Average return on TEA (a)	13.7	15.0
Average TEA funding costs (b)	3.8	3.2
Gross interest margin (c=a-b)	**9.9**	**11.8**
NPLs provisioning (d)	2.6	2.1
Net interest margin (e=c-d)	**7.3**	**9.7**
Non-interest income (f)	11.8	3.4
Total margin (g=e+f)	**19.2**	**13.1**
Overhead expenses (h)	7.9	2.6
Personnel expenses (i)	5.8	5.6
Margin before tax (g-h-i)	**5.4**	**4.8**

Source: NBR and staff estimates.

1/ TEA in billions of RF (exclude earning assets in foreign exchange and NPLs). All other figures are in percent of TEA.

[2] The average cost of funding for the two largest commercial banks is in a 1.6 to 6 percent range; their respective average return on TEA is in a 15.6 to 17.5 percent range.

Except for one large commercial bank and for the SFIs, noninterest income is much needed to cover high overhead and ensure profitability. Finally, the fact that commercial banks' earning assets represent only about 35 percent of total assets, may explain the stickiness of lending rates.

C. Stability and Short-Term Vulnerability

17. **The level of NPLs has declined significantly (Table 4), but asset quality remains a challenge.** Gross NPLs stood at 33 percent in 2004[3] and the NBR has estimated the genocide to account for only a fraction of current levels of NPLs.[4] Subsequent shocks have contributed to new NPLs, including the burst of a real estate bubble that had emerged in the years following the genocide, and losses in the transportation sectors following restrictions on roads in certain bordering countries through which transits most of Rwanda's trade. New NPLs have also reflected banks' weak credit risk analysis, and unwillingness of debtors to repay their debts[5] in a context marked by delays in the judicial system for the collection of collateral. Actions by the NBR to facilitate recovery of NPLs have helped enhance the credit culture. They have included the strengthening of the credit bureau, dissemination of information on delinquent borrowers, and the prohibition for banks to grant new loans to them. Accounting practices, however, blur the information content of banks' balance sheets. In particular, the practice of leaving NPLs which have been fully provisioned on the balance sheet distorts the assessment of banks' solvency. This practice also allows banks to adjust provisioning as needed, in particular by making adjustments to the valuation of guarantees. Therefore, write-off of NPLs should be enforced, as already required by NBR regulations.

18. **Solvency has been strengthened.** As of March 2005, the banking system as a whole, as well as all the banks except for one large bank, are above the 10 percent minimum capital adequacy ratio (CAR), with distribution in the range of 22 percent to 8.7 percent (Table 4). The SFIs are also well capitalized, although the solvency ratio has declined somewhat in 2004 due to high credit growth in one institution.

19. **Risk concentration is a problem that is difficult to address given the structure of the economy**. Crop financing and poor governance in some banks have resulted in large credit exposures to a small number of borrowers. Consequently, prudential limits on risk concentration are frequently breached by banks. The lack of sectoral diversification is a structural obstacle to risk diversification, but encouraging the practice of syndicated lending for large borrowers would help mitigate these risks.

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[3] Excluding the newly privatized banks, NPLs fell to 19.0 percent from 25.6 percent.

[4] It is estimated that 16 percent of loans at end-June 2002 were contracted before the genocide, 72 percent of which are NPLs.

[5] The NBR classified 48 percent of NPLs as "capable, but unwilling to pay" at end-June 2002.

20. Foreign currency deposits account for about 30 percent of total deposits. Until recently (see below), domestic lending in foreign currency was not permitted and banks held foreign assets in correspondent banks. Balances in foreign correspondent bank accounts appear to be callable. While prudential regulations limit their net foreign exchange open position to 20 percent of regulatory capital, the absence of limits on exposure per currency has been utilized by some banks to build cross foreign currency exposures. However, as indicated in the stress test, the impact of changes in cross rates does not appear to represent a major risk to the stability of the banks.

Table 4. Selected Financial Soundness Indicators

	2003		2004		March 2005
(In percent)	Banks	SFIs	Banks	SFIs	Banks
Capital adequacy ratio (CAR)	12.8	27.0	15.0	25.9	15.0
Forex deposits/total deposits	33.2	14.1	32.8	--	31.6
NPLs to gross loans	61.5	10.3	32.7	8.9	34.1
Provisions to NPLs	58.4	152.8	60.2	126.8	88.8
Net NPLs to gross loans	25.6	-5.4	13.0	-2.4	3.8
Net NPLs to capital	85.8	-12.3	81.7	-6.2	25.1
Large exposures to capital 1/	114.8	7.9	213.7	4.3	206.0
Return on assets (ROA)	1.5	1.2	1.8	--	--
Return on equity (ROE)	75.1	8.0	23.9	--	--
Liquid assets to total assets	11.7	8.9	15.1	19.4	22.1
Net forex position to capital	-4.5	--	6.1	--	--

Source: National Bank of Rwanda and staff estimates.
1/ Credit exposures (net of government guarantees and real estate collateral) exceeding 15 percent of regulatory capital.

D. Key Risks and Stress Tests

21. **The mission undertook a range of stress tests to gauge the Rwandese financial system's vulnerability to credit, interest rate, and foreign exchange risk, and contagion in the interbank loan market (Table 5).** Given the structure and activity of banks, different types of credit risk have been considered, including an increase in NPLs, a fall in the value of collateral, a failure of the largest borrowers, and a failure of the largest coffee exporters at the peak of the coffee campaign. Similarly, stress tests for foreign exchange risk include both direct and indirect risk through a deterioration of the asset quality of exporters. Scenarios include a fall in aid flow (Scenario I) and a succession of credit, interest, and foreign exchange shocks (Scenario II).

22. **The financial system is vulnerable to a sharp fall in aid flows (Scenario I) as about 30 percent of bank deposits are in U.S. dollars and are from aid agencies and**

other international organizations[6]**.** Stress test results indicate that four banks representing about 40 percent of deposits would see their CAR fall below the regulatory minimum. In addition, one small bank (representing less than 10 percent of deposits) would have negative capital. An injection of RWF 4 billion (about 0.8 percent of GDP) would be needed for these banks to comply with the prudential capital adequacy requirement. Contagion through the interbank loan market would be limited to the same four banks.

23. **As expected given the structure and activity of banks, credit risk is the main source of vulnerability, and commercial banks are highly exposed to a few large borrowers.** Large exposures are those above 15 percent of regulatory capital. Failure of the three largest borrowers would absorb all the capital in four banks (representing about 40 percent of deposits), and result in a need for capital injections of RWF 10 billion (2 percent of GDP) to reach the minimum risk weighted capital adequacy ratio. Failure of three large coffee exporters at the peak of the coffee campaign (about 80 percent of total loans to the sector) would result in the CAR of two small banks falling slightly below 10 percent.

24. **On the other hand, the financial system appears relatively resilient to a moderate downturn in the economic cycle and to changes in short-term interest rates.** In addition, the sector would be resilient to direct and indirect foreign exchange rate risks, though the indirect risk (through a deterioration of asset quality in the exporting sector) is more pronounced.

25. **A succession of credit, interest rate, and foreign exchange shocks (Scenario II) shows that the problems in the two banks vulnerable to credit risk would spill over to another small bank through the interbank loan market.** Not surprisingly, the same two banks, representing one third of total deposits, would see their CAR fall below 10 percent with a small bank having negative capital. As a result of large cross-exposures in the interbank loan market, an additional small bank would be affected, and these three banks with a total of 38 percent of deposits would end-up with negative capital.

26. **Several measures would help mitigate short term vulnerabilities.** Given the large credit exposures of several banks to individual borrowers, loan syndications among domestic banks, an uncommon practice in Rwanda, would help mitigate risk concentrations and should be strongly encouraged, primarily but not exclusively for the financing of coffee exports. The introduction of a legal framework for collateralized lending would help mitigate the risk of contagion from a default of a large borrower in the interbank market. The NBR should take the lead in this effort which includes developing appropriate legal frameworks; drafting a master agreement; and developing settlement systems that allow a secured transfer of

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[6] The stress tests assume that a sharp fall in aid flows would lead to a 5 percentage point interest rate increase as the government's domestic financing requirement increases; 50 percent depreciation of the RWF/US$ exchange rate as liquidity in the forex market dries up, leading to valuation changes in banks' portfolios; and 66 percent increase of importers' NPLs due to the effect on their activity of the depreciation of the currency.

collateral. In addition, developing hedging instruments for exporters would reduce indirect foreign exchange rate risks, which could be a source of vulnerability in the event of a sharp nominal appreciation of the exchange rate. Given the current limited development of the foreign exchange market, it was suggested that banks be allowed to pre-finance exporters in foreign exchange, and the NBR adopted this recommendation in April 2005.

Table 5. Stress Test Results

		Percent of Deposits		**Percentage Change in CAR for the System**		
		CAR<=0	**CAR<10%**	**Banks and SFIs**	**Banks**	**SFIs**
Fall in value of collateral						
1.	30%			0	-1	0
2.	50%		18	-1	-1	0
3.	70%		32	-1	-1	0
Increase in NPLs + stress test 2						
4.	25%	7	25	-2	-2	0
5.	35%	7	25	-2	-3	0
6.	50%	7	25	-3	-4	-1
Failure of largest borrowers						
7.	1	18	38	-4	-6	0
8.	2	38	38	-6	-6	0
9.	3	38	38	-8	-12	0
Change in interest rates						
10.	-5%		18	-1	-2	...
11.	-10%		43	-2	-3	0
12.	5%			1	2	0
13.	10%		13	2	3	0
Rwf appreciation vs. US$						
14.	10%			...	0	...
Euro depreciation vs. US$ + stress test 14						
15.	30%				0	...
Increase in NPLs to coffee exporters + stress tests 11 and 12						
16.	25%			...	-1	...
17.	50%		18	-2	-3	-0.5
Scenario I						
18.	Fall in aid flows	7	38	-3	-4	0
Scenario II						
19.	2.+4.+10.+15.+16.	7	25	-3	-4	0
Contagion (interbank loans)						
20.	From Scenario I	7	38			
21.	From Scenario II	7	33			

E. Prudential Framework

27. **The NBR carries out its responsibilities in a context of weak "initial conditions" for effective banking supervision**. As elaborated in the Summary Assessment of Compliance with the Basle Core Principles for Effective Banking Supervision (BCP), banking supervision operates in an environment characterized by high vulnerability to external shocks; a concentration of economic activity in a few sectors; a weak credit culture among banks and their customers; the lack of normalized accounting standards and appropriate auditing rules for the non financial sector; weaknesses in the legal and judicial frameworks; weak corporate governance, including in some commercial banks; and a lack of human capital in the sector as well as in the accounting and auditing profession.

28. **Despite such a difficult environment, the NBR has achieved commendable progress, but challenges remain significant**. Following the enactment of the 1999 banking law, markedly strengthened prudential regulations were issued at the end of 2003, including the introduction of IFRS-based accounting standards for the banking sector; the increase of the solvency ratio from 8 to 10 percent; the decrease of permissible deduction of accepted collateral from loan-loss provisions from 100 to 70 percent; and the strengthening of rules on credit concentration, insider lending and credit risk management. Still, while the prudential framework is in broad compliance with best practices, until recently Rwanda has had a history of regulatory forbearance, and the ability of the NBR to effectively intervene in banks, while laid out in the law, has been unsatisfactory. However, an encouraging development is that in early 2005 the NBR acted forcefully against one bank which in the past had repeatedly failed to observe prudential regulations.

29. **Following-up on FSAP recommendations, the NBR has already embarked in a review of the prudential framework.** The following steps have been taken: (i) a review of the banking law to strengthen the framework for corrective action, and provide the NBR with more effective tools to deal with problem or delinquent banks; (ii) the drafting of a regulation on banks' internal governance; ; and (iii) the strengthening of the regulatory treatment of connected lending (i.e., loans to shareholders or members of the Board). Additional measures to be considered are listed in the ROSC summarizing compliance with the BCP. In particular, a revision of the central bank law with a view to specifying the rules for removal of its governing bodies would buttress NBR's supervisory powers, as would making its decisions to be appealable before an administrative tribunal rather than to the Minister of Finance as is currently the case.

F. Anti-Money Laundering and Combating the Financing of Terrorism

30. **The AML/CFT system in the Rwanda is still at an early stage of development**. The criminal system specific to money laundering and the financing of terrorism is not yet in existence, and the preventive system for the financial sector has not yet gone into effect. For these reasons, substantial reform needs to be implemented in order to bring the AML/CFT system in line with international standards. Nevertheless, for various reasons relating to current economic conditions foreign exchange controls, effective law enforcement and

border controls, as well as efforts by commercial banks to implement AML/CFT policies, the risk of money laundering and the financing of terrorism in Rwanda would appear to be somewhat contained at this stage. The implementation of a draft instruction on preventive measures by the NBR, which is expected soon, should materially improve the AML/CFT system. The enactment and implementation of a comprehensive AML/CFT law would still, however, be required to start bringing Rwanda into compliance with best practices. A draft AML law and a draft Anti-Terrorism Law, which should be submitted to Parliament in September 2005, are under preparation.

III. Systemic Liquidity Management and Monetary Policy Implementation

31. **Price stability is the ultimate objective of monetary policy, but policy implementation has also been guided by the broader objective of financial stability**. Concerns about the implications of exchange rate movements on the stability of the banking system (due to exporters' exposure to an appreciation of the exchange rate) have led the NBR to limit the amount of foreign exchange sold at its periodic auctions in order to curtail the appreciation of the currency. Such a practice has benefited banks especially as it prevailed in periods when commercial banks had a large credit exposure to the coffee sector.[7]

32. **Over the past several years the NBR undertook a commendable effort to enhance transparency of monetary policy**. Compliance with best practices, as laid out in the IMF Code of Good Practices on Transparency in Monetary and Financial Policies has been further strengthened by the introduction, in March 2005 of a public Statement of monetary policy (see Annex).

33. **Anchoring monetary policy on a reserve money program has served Rwanda well, but some flexibility in implementation may be warranted to deal with volatility in underlying assumptions.** Volatility in the money multiplier has at times complicated the implementation of the monetary program. Defining a monthly range for the reserve money target, rather than a precise point target, would allow some flexibility and leeway in implementation, while still relying on monetary targeting as the nominal anchor.[8] In addition, the NBR should monitor relevant macroeconomic indicators to gauge the appropriateness of correcting a potential deviation from the initial assumptions, and it should develop a research

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[7] During the May–July 2004 period, when coffee financing was at its peak, the NBR underperformed on its foreign exchange sales by more than 50 percent. Sales in August 2004 were above the planned amount, leading to an appreciation trend of the currency for the remainder of the year. For the year, NBR sales of foreign exchange were 10 percent lower than the targeted amount.

[8] The monthly range would need to be consistent with quarterly performance criteria and benchmarks under the IMF program. Monetary policy during the quarter would have to ensure that banks' excess reserves are kept at a minimum as a sudden rundown of these reserves could jeopardize the program's inflation target. Performance criteria and benchmarks defined as a ceiling may be adjusted during program reviews when justified by a structural change in the money multiplier.

agenda to better understand monetary policy transmission. Progress in this area will allow a shift to a monetary framework reflecting better the determinants of price stability.

34. **The NBR relies on a set of rules-based and market-based monetary instruments which are in line with the level of market development.** The liquidity forecasting framework in place allows an effective coordination of the various monetary instruments (Box 2), and the establishment of a Code of Conduct for the interbank money market has stimulated market activity, and led to a reduced recourse to NBR's lender-of-last resort facility. However, the absence of collateral in interbank money market transactions has increased the potential for contagion in the event of a default by a large borrower. The interbank foreign exchange market is virtually non existent due, to a large extent, to the dominant position of the NBR in the market.

Box 2. Monetary Policy Instruments

Rules-based instruments

Reserve requirements. Gradually reduced since 1995 to the current level of 8 percent, they are in the form of unremunerated deposits with NBR, and denominated in local currency for local currency denominated deposits, and in U.S. dollar for foreign currency deposits.

Refinance standing facility. Banks may borrow on demand from the NBR ("guichet de pension") against collateral in the form of high-quality commercial paper, at a punitive rate (currently 12.5 percent).

Deposit standing facility. Banks may place funds overnight with the NBR at a rate below market rates (currently 5 percent).

Market-based instruments

Weekly deposit or credit auction. The main instrument to inject/withdraw liquidity are money market multiple price auctions ("appel d'offres") of 7-day maturity (at times 14 days). When used to inject liquidity, pledge has to be provided in the form of eligible collateral. The NBR announces a maximum/minimum rate for its deposit/credit auction, which also serves as NBR policy rate.

Primary issuance of t-bills for monetary policy purposes. The NBR auctions t-bills to absorb liquidity for a period longer than 7–14 days (typically 4 weeks). The auctions (multiple price tenders) take place at the same time as sales of t-bills to finance the budget.

Foreign exchange auctions. Because of the structure of Rwanda's balance of payments—a current account deficit financed by official foreign assistance—the NBR conducts weekly auction sales of foreign exchange to authorized banks (multiple-price auctions since November 2004). Bids must be within a +/-5 point range (about 1 percent) from the NBR indicative rate of the day of the auction.

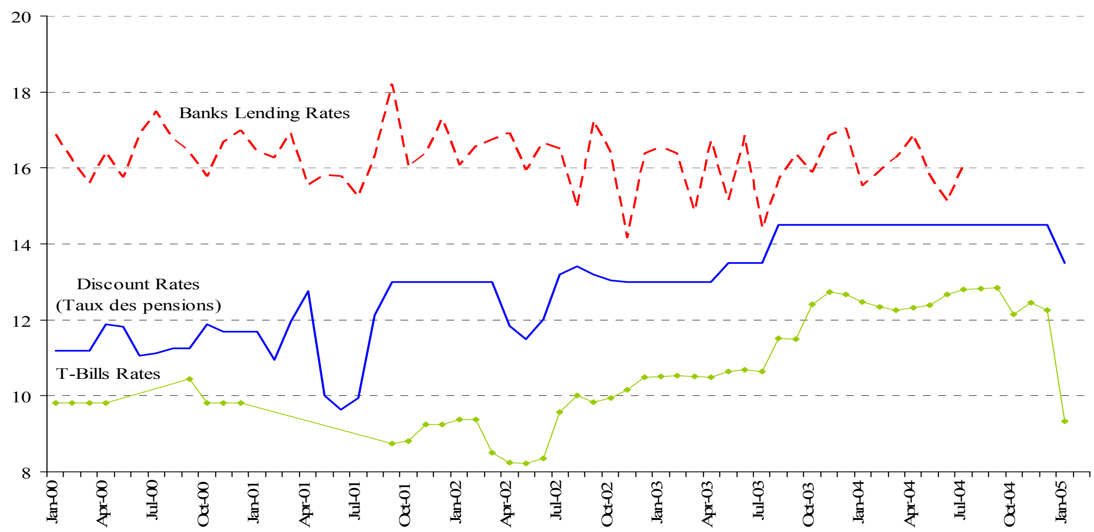
Liquidity forecasting framework

Based on a projection of bank liquidity for the 10-day period ahead, and performance in meeting base money and net international reserves targets, decisions are made for the mix of sales of t-bills for monetary policy purposes, NBR deposit/credit auctions, and NBR foreign exchange auctions.

35. **Systemic liquidity management has been complicated by weak market infrastructure, and the interest rate transmission channel has remained weak**. Progress has been made in strengthening the coordination of Treasury cash management and NBR liquidity management since the creation in 2004 of a joint NBR-MINECOFIN treasury

committee, and the move to a Treasury Single Account expected to be completed by end-2005 will also help. However, shortcomings in the payment systems and the weak liquidity position of some commercial banks have led to operational challenges for NBR liquidity management. Money market interest rates have responded to NBR policy actions, but bank lending rates have been sticky (Figure 1), which points to the oligopolistic structure of the sector, and suggests that bank margins are less sensitive to the cost of resources than other costs, such as provisioning for nonperforming loans (NPLs).

Figure 1. T-Bills and NBR Interest Rates, and Banks Lending Rates (2000–2005)



36. **In line with FSAP recommendations, in July 2005 the NBR has introduced a corridor for interbank market rates with a view to dampen volatility and enhance the interest rate channel of monetary policy**. In order to stabilize the money market and prevent market rates from under or overshooting, the NBR has established a deposit standing facility which, combined with the current refinance standing facility, forms a corridor for short term market rates. In order to enhance the interest rate channel, the NBR has also adopted a policy rate whose level will reflect market conditions.

IV. Increasing the Outreach of the Financial Sector

37. **Ongoing reforms, recent privatizations and recapitalizations, and the growth in outreach of the credit cooperative network, are encouraging steps towards broadening access to financial services**. In the interim, government and donor efforts should focus on capacity building, and the authorities are encouraged to focus their efforts in specific segments of the financial sector as well as on market infrastructure.

A. Strengthening Market Infrastructure

Legal and judicial framework

38. **As recommended by the FSAP mission, the authorities have indicated their intention to establish a Law Reform Committee to prioritize and coordinate the update of the legislative framework.** Notwithstanding the amount and quality of legislative reform accomplished, there remains a challenging task ahead to update the legislative framework for the commercial and financial sectors. Rwanda's new Constitution provides for essential elements affecting the financial sector such as the independence of the Judiciary. In addition, certain other basic laws, most notably those affecting the country's judicial system, have recently been entirely re-written. These laws govern the functioning of the Superior Council of the Judiciary, the status of judges and other judicial personnel, the organization, functioning and jurisdiction of the Courts, the creation of commercial chambers, and civil, commercial, labor and administrative procedures. However, most of the existing legislative framework is dated, and there is a need to undertake a comprehensive review.

39. **Secured lending is affected by numerous constraints**. In addition to the weaknesses already discussed with regard to real estate collateral, alternatives to mortgage-based financing should be developed to facilitate access to credit to those businesses and individuals who do not own real property. That would include creating a registration-based secured interests system that allows the debtor to possess and use the asset being provided as security (such as automobiles, equipment and securities), and adopting an adequate framework for leasing activities. Furthermore, debt collection mechanisms show mixed results and the insolvency framework does not ensure efficient exit mechanisms.

40. **Important features of the laws enacted in 2004 for the judicial system are not yet operational, and, thus, the new system remains to be tested.** Of particular concern to Rwanda's financial sector is the current inability to litigate due to the lack of an official list of appointed and trained volunteer lay judges (*assessors*) for the newly established commercial chambers. Consequently, no significant commercial or credit-related litigation has proven possible for over nine months. Therefore, it is time either to amend the existing legislation or to re-examine the proposed system. Furthermore, the Rwandese justice system continues to suffer from a lack of qualified personnel and material resources. There is a clear need to strengthen the training of magistrates in commercial and financial matters.

Accounting and auditing

41. **The absence or unreliability of companies' financial statements creates significant asymmetries of information which are obstacles to bank lending**. All commercial companies incorporated in Rwanda are required by law to prepare annual financial statements. However, the current legislation does not provide any sanction in the event companies fail to do so, and one has to appreciate that the law may be difficult to

enforce until the current shortage of qualified chartered accountants is resolved.[9] In addition, accounting regulations are obsolete and not followed in practice; they need to be updated.

42. **The authorities are cognizant of the urgent need to address deficiencies in accounting and auditing.** To this end, a steering committee has been formed to draft legislation and establish a professional association, and a body responsible for the certification of chartered accountants is being set up. The most pressing issues that need to be addressed include setting appropriate accounting standards for different categories of companies operating in Rwanda.

Payment systems

43. **The authorities have started the implementation of an ambitious plan to modernize the payment systems.** The objective is to introduce noncash instruments in an economy still predominantly cash-based. In February 2005, a credit/payment card system (SIMTEL) was launched.[10] In parallel, the NBR has embarked on a modernization plan of payment systems infrastructure at its head office and branches. Several measures would facilitate the coordination and smooth implementation of these important initiatives:

- First, the National Payment Council needs to be re-activated. It should coordinate all payment systems initiatives, with the assistance of an Executive Payment Committee in charge of preparing and implementing decisions.[11]

- Second, the legal framework for payment systems needs to be brought in line with the card system (SIMTEL) recently launched. In particular, provisions need to be introduced in the NBR law to specify the central bank's role in the payment system, and implementing regulations need to be issued, in coordination with SIMTEL, covering card activity, settlement of operations, normalization of payment instruments, and the exchange of data.

- Third, the NBR payment systems unit needs to be strengthened and empowered to take key actions and decisions. These would include preparing policy decisions to be adopted by the National Payment Council; implementing regulations; monitoring the readiness of commercial banks to use any new instruments and systems; and overseeing the good functioning of the overall payment system.

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[9] There are only a dozen qualified chartered accountants in the country. The University of Rwanda and School of Finance and Banking (SFB) have started offering degrees in accounting, and there are currently 80 students pursuing the accounting program at SFB.

[10] SIMTEL is a card processing system that can also provide electronic instruments of payments to pay bills to major services providers.

[11] The authorities have indicated their intention to reactivate the National Payment Council by October 2005.

44. **In view of the importance of the UBPR in the provision of financial services, the process of automation of its customer accounts should be accelerated.** In order to allow its members access to automatic payment services, computer resource centers shared by individual institutions could be installed at the district level, and these centers should be interconnected with UBPR through a shared communication network.

B. Developing the Financial Sector

Microfinance sector

45. **The microfinance industry in Rwanda contributes significantly to the provision of basic financial services, but it lacks capacity in several areas**. About 80 percent of the households holding an account in a financial institution are serviced by the UBPR network. However, the reach of other MFIs remains limited, and most of them are fully extended in the use of their resources. To access additional resources, MFIs could seek refinancing from the banking sector, which is likely to prove a more sustainable source of funding than donors. Apart from the UBPR, the majority of MFIs seem to lack capacity in several areas that are important to manage a financial institution profitably. Capacity building is needed in management, accounting, internal controls, development of new products, and setting up Management Information Systems (MIS), which only very few institutions in Rwanda are able to provide.

46. **The regulatory framework for MFIs needs to be further strengthened.** While it takes into account all the elements necessary to ensure financial soundness, and recognizes differences with banks, the minimum capital adequacy ratio, at 10 percent, is below the recommended international guidelines of 12–15 percent, that is meant to recognize the specific risks of the microfinance business and the volatility of MFIs' portfolio. Also, the rules for provisioning NPLs are less severe than best practices for MFIs which recommend 100 percent provisioning for loans delinquent for more than 180 days. As a result, the NBR should strengthen the prudential framework for MFIs

47. **The NBR has set up a unit for the supervision of MFIs, but current staffing is insufficient. The** NBR has adopted the view that all MFIs should be licensed and supervised. However, it is not clear that this needs to be the case, and it would be advisable to first identify all MFIs in operation and then decide upon an appropriate threshold for supervision. Consideration should be given to not imposing prudential regulations on "credit-only" MFIs that merely lend their own capital or resources borrowed from regulated local banks; not granting a license to take deposits until the applicant has demonstrated that it has the financial and administrative capacity to manage its business; and allowing small community-based intermediaries to continue taking deposits from members without being prudentially supervised.

Nonbank financial institutions

48. **The scope for development of the insurance sector is substantial, but significant weaknesses in the regulatory and supervisory framework, as well as the shortage of experienced professionals, constrains the sound development of the industry.** With only four companies in operation, insurance penetration is low (premium to GDP ratio at 0.4 percent), and assets in the sector account for only 1.7 percent of GDP. However, interest in entering the local market by four foreign firms from neighboring countries suggests that there is a potential for development. Against this background, the current insurance law falls short of international standards; the sector is de facto not supervised;[12] there is a shortage of experienced practitioners; and accounting norms for the industry have not yet been defined. These shortcomings will constrain the sound growth of the industry and reduce its potential contribution to the development of the financial sector. Given the shortage of local expertise, the authorities will need to seek external assistance to set in motion a process to address all of these shortcomings.

49. **Contribution of the pension system to the development of capital markets in Rwanda is constrained by a number of factors.** The system has positive cash flows, substantial reserves (20 percent of total financial assets), and an appetite for long-term assets. In practice, however, its contribution of the development of capital markets is limited, first and foremost, by the dominance of government arrears on its balance sheet.[13] Moreover, accruing deficits are likely to result in a drying up of reserves over the medium term unless fundamental parametric reforms are undertaken. Other obstacles include current investment practices, which have directed available funds to short-term government securities and bank time deposits in the absence of alternatives. The authorities need to undertake a comprehensive review of the pension system, with a view to ensuring the system's long-term financial viability, and strengthen its operations so that it can contribute to the development of the capital market. One specific measure to consider to that effect would be to securitize part or all of the current government arrears in order to provide the pension system with a tradable long-term debt instrument.

Real estate finance

50. **The legal and regulatory infrastructure for real estate finance is adequate, and several weaknesses in land ownership and registration that so far have prevented the practice of mortgage lending are being addressed**. Property rights are protected by a legal framework that should be secure in principle both for owners and holders of property liens

[12] The 2002 Insurance Law established the supervisory body *Commission Nationale de Contrôle des Assurances* (CNCA). However, the CNCA is not yet operational, and the legal framework is weak.

[13] The government owes RF 57 billion to the system (77 percent of total assets and 6 percent of GDP). These arrears date from prior to 1998, and the government has since resumed regular contributions. A rescheduling plan is under discussion.

where it applies. However, the land administration system is weakened by (i) the limited scope of the cadastre and land registries, which incorporate only about 20 percent of the land in the capital; (ii) serious operational shortcomings that hamper the capacity of the land department to meet demand and that jeopardize the integrity of records; and (iii) a legal provision that links full title to the near completion of construction. These weaknesses are currently being addressed. Furthermore, an overhaul of the Kigali land administration is under way, which will expand the scope of registered properties, create a computerized land information system and improve the collection of taxes and duties. The new system is expected to be ready within two years.

51. **Lenders also appear to be able to foreclose and exercise mortgage rights effectively.** The legal framework has been recently strengthened, with deadlines imposed on courts, and strict limits set on delaying tactics. The law governing "fast track" foreclosure procedures has recently been strengthened. The new framework should ensure an expedient exercise of security rights that used to take up to several years. However, it remains to be tested, and the commercial court chambers that will implement it are still to be actually established.

52. **Against this relatively favorable background, the introduction of simple mortgage-backed instruments can be envisaged to help address the lack of long-term resources for housing finance.** The authorities may wish to consider developing debt instruments collateralized by mortgage loans, thus offering credit enhancement vis-à-vis unsecured instruments. Such instruments can be negotiable through endorsement, without being tradable securities, and therefore without requiring the same levels of disclosure or market infrastructure required of capital market instruments.

53. **Basing the operations of the CHR on commercial principles would also support a development of real estate finance.** Following a recapitalization by the government, the CHR (re-labeled Banque de l'Habitat du Rwanda in April 2005) has prepared a business plan which rightly emphasizes resource mobilization, a major challenge for a lending institution without a branch network or access to an established bond market. However, the CHR continues to benefit from subsidized funding.[14] In order to play a catalytic role in the market and to ensure its own sustainability, CHR should be run as a commercial operation with standard profitability targets. The large capital injection it has received should be considered as sufficient government backing to give a new start to the institution, and CHR should then be able to demonstrate the value it brings to the market through its expertise and franchise as a specialized lender.

[14] CHR benefits from 25 year loans at 2 percent interest, allocated to housing loans to civil servants. These conditions create protected niches at the expense of other financial institutions that cannot compete for the same customers, and the market segmentation prevents competition.

Increasing equity and term finance

54. **The authorities are gauging how best they can help develop medium- and long term financial instruments.** Rwanda faces still a number of structural obstacles for the establishment of a stock exchange. There does not seem to exist yet the critical mass of businesses to allow the smooth development of a stock market. In particular, most of the enterprises in Rwanda are closely held, often family-owned businesses, and may have little or no interest in ceding control to outside shareholders. In addition, modern concepts of good corporate governance are not widely known or practiced, and the small size of the business community makes it difficult to maintain arm's lengths relations and protect minority shareholder rights. Finally, neither the base of institutional investors, nor the market infrastructure has reached a level that would allow the stock market to be sustainable.

55. Against this background, the authorities and private sector should investigate cost effective solutions to address the lack of long-term savings and credit. This would involve thorough analysis of the potential supply and demand for term capital (both equity and debt), and the obstacles that have prevented the emergence of a private market. Some fairly basic forms of term finance that are particularly adapted to SMEs, such as leasing, for example, might represent a logical starting point for the development of term finance for most Rwandese companies. Venture capital represents another possibility. Unlike organized securities markets, private equity is scaleable, with costs and due diligence incurred by the investors, and therefore does not entail the high regulatory or other fixed costs associated with a stock exchange.

Observance of Financial Sector Standards and Codes—Summary Assessments

This annex contains summary assessments of international standards and codes relevant for the financial sector. The assessments have helped to identify the extent to which the supervisory and regulatory is adequate to address the potential risks in the financial system.

The following assessments of financial standards were undertaken:

- The Basel Core Principles for Effective Banking Supervision (BCP), by Didier Debals (Banque de France) and Samira Ghribi (Banque Centrale de Tunisie).
- The IMF Code of Good Practices on Transparency in Monetary and Financial Policies—Transparency of Banking Supervision, by Didier Debals (French Banking Commission) and Samira Ghribi (Central Bank of Tunisia).
- The IMF Code of Good Practices on Transparency in Monetary and Financial Policies—Monetary Policy, by Krzysztof Bledowski (IMF/AFR).
- The FATF Recommendations for Anti-Money Laundering Combating the Financing of Terrorism (AML/CFT), by World Bank team led by Emile van der Does de Willebois and comprising Boudewijn Verhelst (law enforcement expert, Belgian Financial Intelligence Processing Unit), and Richard Gordon (financial expert, consultant).

The assessments were carried out during visits to Rwanda in February and March 2005. Additional information was added during the review process. All the assessments were based on the laws, regulations, policies and practices in place at the time the assessments were made.

The assessments were based on the following sources:

- Self-assessments by the supervisory authorities;
- Review of the relevant legislation, decrees, regulations, policy statements and other documentation;
- Detailed interviews with the supervisory authorities, as well as with other authorities, including the Ministries of Finance and Justice; accountant and auditing firms.

Basel Core Principles

General

56. This review covers the activities of the National Bank of Rwanda (NBR). It was prepared on the basis of the Basel Core Principles Methodology, a self-assessment by the Rwandese authorities, and the response to the FSAP questionnaire. Furthermore, the mission studied laws and regulations relative to banking regulation and supervision, and held discussions with representatives of the NBR, as well as with representatives of the commercial banks and specialized financial institutions, and of the accounting and auditing profession. Also, annual reports of the NBR were consulted, as well as its websites.

Institutional and macroprudential setting, market structure—overview

57. The NBR is the only body responsible for banking supervision. In that capacity it has broad regulatory, accounting, and disciplinary powers. The Governor of the NBR is appointed and dismissed by the President of the Republic, to whom he reports the results of his supervisory mission. Banking supervision combines off-site and on-site audits, with the same officers performing both types of audit.

58. The financial sector comprises six general-purpose commercial banks, three specialized financial institutions (SFIs). Significant developments in 2004 were the sale of majority stakes of two state-owned banks to foreign investors, following their recapitalization. As a result, soundness indicators have improved, but asset quality remains a challenge. The profitability and efficiency of the commercial banks and SFIs bounced back in 2003 and 2004, indicating that the system has overcome shocks that occurred in the late 1990s.

General preconditions for effective banking supervision

59. The low domestic saving ratio exposes Rwanda to a risk of uncertain foreign aid inflows. This, together with the significant vulnerability arising from large credit exposures of several commercial banks, constitutes the most significant risk to the stability of the banking sector. The other sources of vulnerability include governance problems in some of the banks, and, until the most recent period, weak enforcement of prudential regulations.

60. The legal and regulatory framework for banking supervision is clear, easily accessible and updated periodically. However, the Finance Ministry possesses broad powers to oversee the NBR, which may curtail its independence. Furthermore, the legal and accounting framework does not favor the development of a sound and sustainable business environment. The quality of financial information could benefit from an overhaul of the accounting system used by enterprises, by establishing a well organized group of chartered accountants, and by extending the outside audit obligation to all firms. Likewise, the realization of collateral is hampered by slow and cumbersome judicial procedures. Finally, given the presence of individuals among the shareholders in some banks, particular attention needs to be paid to the governance function in the allocation of credit.

61. A number of the prerequisites for the establishment of a deposit insurance scheme are not in place. Therefore, a prudent approach is warranted in this area, since introducing such a scheme could result in increased moral hazard and impair financial discipline in the institutions that would benefit from it.

Main findings

62. While operating in a context of weak initial conditions for effective banking supervision, NBR's banking supervision department has achieved commendable progress, and the quality and effectiveness of supervision have improved. In particular, the 1999 banking law was followed by the enactment of markedly strengthened prudential regulations issued at the end of 2003, including the introduction of IFRS-based accounting standards for the banking sector; the increase of the solvency ratio from 8 to 10 percent; the decrease of permissible deduction of accepted collateral from loan-loss provisions from 100 to 70 percent; and the strengthening of rules on credit concentration, insider lending, loan management, and, most significantly, the restructuring of the banking sector.

Objectives, Autonomy, Powers, and Resources (CP 1)

63. The NBR has the regulatory powers to supervise the commercial banks and SFIs, including the powers to grant or withdraw licenses, and to impose administrative measures and disciplinary sanctions. The NBR is also the agency in charge of issuing prudential rules, and to collect all information deemed necessary to discharge its responsibilities. However, the autonomy and powers of the NBR may be impaired due to the fairly broad powers granted to the Minister of Finance in overseeing the NBR (i.e., NBR's decisions may be appealed before an ad hoc commission established by the Finance Minister), and the absence of legal specification of the grounds on which the Governor may be dismissed. The shortage of staff involved in supervision could also impair the quality of NBR oversight.

Licensing and Structure (CPs 2–5)

64. Bank licensing rules are adequate. In particular, licensing criteria are established in the law; they comprise requirements with regard to minimum capital, a business plan, operational capacity to observe legal and regulatory provisions, and prior consent of the home country supervisor in the case of a majority foreign bank ownership of equity in institutions applying for a license. Furthermore, the NBR has the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties. However, there are no specific criteria for participations in financial enterprises, which may expose the sector to excessive risks.

Prudential Regulations and Requirements (CPs 6–15)

65. From a regulatory point of view, the solvency ratio appears to be broadly in line with the 1998 Basel Capital Accord. In particular, it has only a few shortcomings in view of the operations of Rwandese banks; the solvency ratio is set at more than 8 percent; adequate

procedures are in place for evaluating the quality of assets and the adequacy of loan loss provisions and reserves. On the other hand, in the past enforcement has been weak and noncompliance not always followed by disciplinary action; the regulation governing the terms on which credit may be extended to related parties needs to be strengthened; single currency limits on banks' foreign exchange exposures would be desirable; the prudential framework for operational and liquidity risks needs to be strengthened; and no framework is in place for combating money laundering and financing of terrorism.

Methods of Ongoing Supervision (CPs 16–20)

66. The NBR conducts both on-site and off-site supervision. Periodic financial statements provided by the financial institutions are used for off-site audits, including the production of quarterly analytical notes. On-site audits, which are conducted in accordance with an annual schedule, may be either general or specific, with all financial institutions being covered in a two-year cycle, although the larger institutions and those in difficulty are reviewed in a one-year cycle. Ongoing supervision could be further strengthened by allocating additional staff to NBR's supervision department; if greater focus was given to analyzing the type of risks in the terms of reference for on-site audits; and through regular contacts with financial institutions' external auditors.

Information Requirement (CP 21)

67. A new chart of account based on international standards (IFRS) was introduced in 2004, and financial institutions are required to publish quarterly information on their financial position and net income. The published data have to be certified by auditors duly authorized by the NBR. Sanctions for non compliance with all of those legal provisions may be imposed. However, there are still deficiencies in the accounting systems of certain financial institutions due to delays in implementing the new chart of accounts.

Formal Powers of Supervisors (CP 22)

68. The central bank has at its disposal a wide range of disciplinary options to deal with noncompliant financial institutions. However, until the most recent period, Rwanda has had a history of regulatory forbearance, and the ability of the NBR to effectively intervene in banks, while laid out in the law, has been weak. In the past, some banks, while frequently breaching prudential regulations, have managed to avoid paying penalties or having a temporary administrator appointed by the NBR. However, more recently, the NBR has taken firm action against repeated offenders.

Cross-Border Banking (CPs 23–25)

69. The subsidiaries of foreign banks operating in Rwanda are subject to the same regulatory and prudential framework as local banks. Furthermore, as indicated above, the NBR follows the practice of seeking the prior consent of the home country supervisor in the case of a majority equity stake of a foreign bank in an institutions applying for a license.

However, so far, no formal agreement has been signed with the supervisors of foreign banks operating in Rwanda o allow a sharing of information.

Recommended Action Plan

Table 1. Recommended Action Plan to Improve Compliance with the BCP

Subject	Recommended Actions
Objectives, powers, resources (CP 1)	Specify in legislation the grounds for removing the Governor, vice Governors and members of the Board of Directors, and the binding nature of NBR decisions. Make the decisions taken by the NBR to be appealable before an administrative tribunal. Increase staffing of NBR's banking supervision department.
Licensing and stockholders (CP 2 to 5)	Amend the banking law with a view to including a definition of principal or benchmark stockholders capable of providing the necessary support in an emergency. Introduce regulations on banks' governance so as to enhance the management of operational risks.
Prudential regulations, internal controls, and risk management (CP 6 to 15)	Amend the solvency ratio with a view to introducing a definition of supplementary equity; harmonizing the definition of risks used in prudential ratios (solvency, concentration, loans to related parties); discontinuing the deduction of real estate collateral for assessing the level of exposure to borrowers. Strengthen regulations on lending to related parties, and extend the concept of relatedness to include family members of the stockholders, directors, and managers, as well as to enterprises owned by employees of the bank. Deduct loans to related parties from equity when calculating prudential ratios. Introduce a framework for combating money laundering and financing of terrorism.
Off-site and on-site audits (CP 16 to 20)	Expand on-site audits to include I.T. security and AML-CFT. Adopt a qualitative approach in the terms of reference for on-site audits, and indicate the main types of risk threatening the institution. Hold routine meetings with external auditors of banks and SFIs.
Accounting and audit (CP 21)	Harmonize provisioning rules with international standards. Develop partnership relationship with the banks and SFIs, for instance by reviving the role of the Banking Association.
Intervention measures (CP 22)	Tighten the regulatory framework to deal with problem banks in order to prevent postponement of corrective measures, and specify in a NBR Instruction the scope of the corrective measures and the conditions required for their implementation.
Supervision of affiliated institutions operating abroad (CP 23 to 25)	Sign agreements for the exchange of information between supervisors in the home countries of foreign banks with a controlling share in local banks.

Authorities' response

70. The authorities are broadly in agreement with the assessment, but they indicated that they needed further consideration before they can envisage to specify in the NBR law the grounds for removal of the Governor, vice Governors and members of the Board of Directors.

IMF'S TRANSPARENCY CODE—TRANSPARENCY OF BANKING SUPERVISION

General

71. This assessment of observance of the code of good practices on transparency of banking supervision is based primarily on the Banking Law, information available on the NBR's website, NBR publications, and discussions with the directorate for banking supervision. The assessment methodology was based on the Supporting Document to the Code of Good Practices on Transparency in Monetary and Financial Policies prepared by the International Monetary Fund (July 2000), a self-assessment by the Rwandese authorities, and the response to the FSAP questionnaire. The NBR is the body that supervises banks and specialized financial institutions in Rwanda.

Main findings

72. Over the past several years the NBR has undertaken a commendable effort to disseminate information through public statements, interviews, print publications, and website postings. The upcoming revision of the central bank law is expected to remedy some of the deficiencies identified by the assessment.

Clarity of roles, responsibilities, and objectives of the financial organs responsible for financial policy

73. The banking law clearly specifies the broad objectives of the NBR with regard to banking supervision; the various components of NBR's authority to license and supervise commercial banks and specialized financial institutions; and its regulatory powers, including powers to impose prudential norms and to appoint temporary auditors and administrators, or a liquidator with regard to financial institutions in difficulties.

74. The grounds for appointing senior officers to the NBR are well laid out in the law, but the rules that deal with their removal from office are absent.

Transparency in the preparation and announcement of financial policy

75. The regulatory framework and operating procedures are publicly disclosed, as well as the regulations governing the activities of the NBR with regard to banking supervision. Changes in financial policies are mentioned and explained in the NBR Annual Report.

76. However, the absence of a preannounced calendar for the publication of the NBR Annual Report and delays in its publication limit transparency of policy. In addition, the NBR does not publish the resolutions of its Board of Directors on major changes in financial policy. Finally, while the NBR has consulted banks and financial institutions prior to the introduction of major changes in financial policy, there is no framework for systematic consultation.

Public access to information regarding financial policy

77. The NBR Annual Report describes developments in the sector, and the Governor may hold press conferences, or make speeches which may be posted on the NBR website. However, there are no aggregated data published on observance of prudential standards.

Accountability and assurances of integrity of the central bank

78. The Governor of the NBR is accountable for his actions to the President of the Republic, and the NBR is required to submit to the President the balance sheet and profit and loss accounts of the NBR, as well as a report on its activities. These financial statements have to be published in the official gazette. However, there is no preannounced schedule for publication, and delays have occurred in the past.

Recommended Action Plan

Table 2. Recommended Action Plan to Improve Observance of the MFP Transparency Code Practices—Banking Supervision

Subject	Recommendations
Clarity of roles, responsibilities and objectives	Specification in the NBR law of the rules for removal of the Governor, vice Governors and members of the Board of Directors would strengthen transparency, as well as consistency with best practices.
Open process for formulation of financial policies	Reviving the role of the Banking Association would facilitate systematic consultation with banks and specialized financial institutions prior to any substantive change in supervisory policy.
Public availability of information	Publication of aggregate data on prudential standards in the NBR's annual report or in a special report would enhance availability of information. Publication of the NBR Annual Report with a set deadline would enhance transparency of information on banking supervision.
Accountability and assurances of integrity by financial agencies	Publication of the NBR Annual Report and financial statements with a set deadline would enhance accountability. Regular briefings of the Governor to parliament would enhance accountability.

Authorities' response

79. The authorities are broadly in agreement with the assessment, but they indicated that they needed further consideration before they can envisage to specify in the NBR law the grounds for removal of the Governor, vice Governors and members of the Board of Directors.

IMF's Transparency Code—Transparency of Monetary Policy

General

80. This assessment of observance of the code of good practices on transparency of monetary policy is based primarily on central bank law, information available on the NBR's website, NBR publications, and discussions with NBR's directorates in charge of monetary policy implementation. The assessment methodology was based on the Supporting Document to the Code of Good Practices on Transparency in Monetary and Financial Policies prepared by the International Monetary Fund (July 2000).

Main findings

81. Over the past several years the NBR has undertaken a commendable effort to disseminate information through public statements, interviews, print publications, and website postings. The code was further strengthened when the NBR introduced in March 2005 a Public Statement of Monetary Policy, a quarterly summary of monetary developments and a policy orientation for the coming year. The upcoming revision of the central bank law is expected to remedy some of the deficiencies identified by the assessment.

Clarity of roles, responsibilities, and objectives of the central bank for monetary policy

82. The central bank law has been published in the official gazette and on the NBR website. It sets the ultimate objective of monetary policy; the institutional framework of monetary policy and the general missions and responsibilities of the NBR. The central bank law specifies that it can utilize monetary policy instruments to achieve its objectives.

83. The central bank law clearly defines the institutional relationships between monetary and fiscal operations, and periodic NBR publications indicate the amounts, terms of credit, advances, or overdrafts to the government by the central bank. The central bank law also specifies the procedures for central bank participation in the primary and secondary markets for government securities. Moreover, it specifies the manner in which central bank profits are allocated and how its capital should be maintained. However, the operational arrangements for a recapitalization of the NBR, in the event that losses cannot be amortized by imputation on the general reserve fund, are not specified in the law.

84. The grounds for appointing senior officers of the NBR are laid out in the central bank law, but the rules that deal with their removal from office are absent.

Open process for formulating and reporting monetary policy decisions

85. The framework, instruments and targets that are used in monetary policy design and implementation are disclosed, including through the publication of the IMF's PRGF programs documents, and through the Public Statement of Monetary Policy, and a quarterly update of its implementation. However, neither the composition nor the structure of the

Monetary and Exchange Policy Committee—the body which takes operational decisions on liquidity management—has been made public. However, there is no preannounced schedule for NBR Board of Directors meetings and its resolutions are not published.

Public availability of information on monetary policy

86. The NBR's public information service delivers statistical datasets, financial instructions, NBR's regulations in a timely and detailed manner, in particular through its website. However, the public would benefit from a preannounced schedule of NBR's publications of its balance sheet and annual report.

Accountability and assurances of integrity by the central bank

87. The Governor of the NBR is accountable for his actions to the President of the Republic, and the NBR is required to submit to the President the balance sheet and profit and loss accounts of the NBR, as well as a report on its activities. These financial statements have to be published in the official gazette. However, there is no preannounced schedule for publication, and delays have occurred in the past.

Recommended Action Plan

Table 3. Recommended Action Plan to Improve Observance of MFP Transparency Code Practices—Monetary Policy

Subject	Recommended Action
Clarity of roles, responsibilities and objectives	Specification in the NBR law of the rules for removal of the Governor, vice Governors and members of the Board of Directors would strengthen transparency and consistency with best practices, as would a specification of the operational arrangements for recapitalizing the central bank.
Open process for formulating and reporting monetary policy	Publication of the resolutions of its Board of Directors regarding significant changes in monetary policy would enhance transparency. Disclosure of the composition of the monetary policy making body and the timing of monetary policy meetings would enhance transparency.
Public availability of information	Publication of the NBR Annual Report and audited financial statements with a set deadline would enhance transparency of monetary policy.
Accountability and assurances of integrity by the central bank	Regular briefings of the Governor to parliament would enhance accountability, as would the publication of NBR Annual Report and financial statements with a set deadline.

Authorities' response

88. The authorities are broadly in agreement with the assessment, but they indicated that they needed further consideration before they can envisage to specify in the NBR law the grounds for removal of the Governor, vice Governors and members of the Board of Directors.

FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism

General

89. This summary assessment of observance of the FATF 40 Recommendations for Anti-Money Laundering and 9 Special Recommendations on Combating the Financing of Terrorism is based on the review of the relevant (draft) anti-money laundering/combating the financing of terrorism (AML/CFT) laws and regulations and the relevant supervisory and regulatory systems among financial institutions and designated non-financial businesses and professions. The capacity and practice of criminal law enforcement agencies were also reviewed. The assessment is based on the information available at the time the assessment was completed on March 18, 2005.

Main findings

90. Rwanda is a hilly, land-locked country, with around 90 percent of the population engaged in agriculture, most of which is subsistence in nature. The cash economy is primarily based on medium and small-scale tea and coffee cultivation and international aid. The government has maintained effective anti-crime and, more specifically, anti-corruption strategies, such that by all accounts the major proceeds-generating crimes are not a significant problem in Rwanda.

91. There are no documented reports of money laundering in Rwanda, probably due to effective law enforcement initiatives, particularly anti-corruption strategies. Due in part to ongoing threats from rebels located in the Democratic Republic of Congo, Rwanda maintains a relatively large and standing army and domestic police force.[15] These widely deployed forces, when superimposed on the country's isolating geography, make the country's borders relatively secure against unlawful entry and smuggling. Furthermore, foreign exchange controls and a small financial sector greatly reduce the attractiveness of Rwanda as a place to bring the proceeds of foreign crimes, and the mission found little evidence that money laundering or terrorism finance was a significant problem in Rwanda.

92. On the other hand, Rwanda continues to be faced with a significant challenges relating to the aftermath of the 1994 genocide. Projects to draft a new constitution and a new set of civil and criminal laws have begun to bear fruit: the new constitution was adopted in 2003, and over the past 6 years laws on banking regulation, exchange controls, corruption, the public prosecutor, and criminal procedure have been enacted. Additional key laws on contracts, companies, bankruptcy, and crimes are nearing completion now. While the police and customs forces have been in place for some time and appear to be effective, the courts

[15] There is, however, no indication that these groups benefit from any significant financing from within Rwanda, and Rwandese security officials do not view this as an important threat.

were completely restructured in 2004, resulting in the replacement of a substantial part of the judiciary with new and largely inexperienced judges, many straight from university.

Legal system and related institutional measures

93. Rwanda has recently started to take action to address ML and TF concerns, and currently has only one criminal provision that directly relates to TF. Law no 23/2003 on the prevention, suppression and punishment of corruption and related offences (the Anti-Corruption Act) punishes the laundering of proceeds related in any way to corruption. There have, as yet, been no instances of prosecution or confiscation under this provision.

94. Articles 179 and 431 of the Criminal Code criminalize receiving objects obtained by crime or misdemeanor. These articles do not apply to the person who has committed the predicate offense. For a successful prosecution the underlying crime must be proved. While these articles could in theory be used to prosecute certain instances of money laundering and other financial crime cases, the team was not informed of any case of such a prosecution.

95. There are currently no provisions in the law that relate directly to TF. Articles 151 and 164 of the Criminal Code criminalize terrorist acts (which are not defined) to the extent the perpetrator intends to cede Rwandese territory to foreign powers or attacks the national authorities or "constitutional principles." As yet there has been no criminal prosecution based upon these articles. Rwanda does have standard provisions in the Criminal Code that criminalize such behavior as kidnapping, arson, and murder regardless of whether the intent was to influence the behavior of the government. The deliberate financing of such crimes could be prosecuted as conspiracy to commit the crime under the Criminal Code.

96. There is some awareness among law enforcement authorities of ML and TF issues but as yet no (potential) threat has been detected. The national police force has created special units targeting economic/financial crime (Economic and Financial crime unit), and terrorism (Anti-terrorist unit), and the writ of the constitutional office of Ombudsman includes investigation of corruption. There is no FIU, although the NBR is to be designated in a draft Instruction (discussed below) as the authority to which suspicious transactions and related information reports are to be reported. While there have been a number of bank fraud and corruption prosecutions, none has involved significant amounts of money. The authorities indicated that a wide range of investigative techniques would be available, although, except for telephone tapping and interception of communications there is no legislative or formal regulative framework for these techniques. It was unclear whether the fact that there is such explicit basis for some methods implies that any technique actually requires an explicit legislative basis. While there has been some special police training in ML issues provided by FATF member states, there is a general lack of expertise among law enforcement authorities.

97. Although the risk of laundering is relatively small, the authorities are taking steps to bring Rwanda into compliance with the FATF 40 + 9 standard. Pursuant to a request from the NBR, a WB/IMF AML/CFT technical assistance mission visited Kigali in July 2004.

Thereafter, Rwanda established a task force to draft a new AML law, which should submitted to Parliament in September 2005.

98. Following the adoption of UN Resolution 1373 in 2001, Rwanda put in place a national committee to coordinate anti-terrorism efforts and to implement the terms of the Resolution. The committee is currently in the final stages of drafting a new anti-terrorism law that will include provisions on terrorism finance. The law has been sent to the UN's Counter Terrorism Committee for comments, and should be submitted to Parliament in September 2005.

Preventive measures-financial institutions

99. The Banking Law (Law no 8/99 of June 18, 1999) includes two articles relating to preventive measures: Article 16.2 requires financial institutions subject to the supervision of the NBR to communicate to the NBR any information on funds linked to illegal activity and forbids them from transferring or managing such funds. Article 78 requires supervised financial institutions to verify that the origin of client funds is not illicit. There are currently no supervisory regulations that implement these articles.

100. However, in part due to the presence of foreign shareholders, and because of concerns of correspondent banks, commercial banks have begun to implement preventive measures, including customer due diligence and customer acceptance, maintenance of client documents, and internal programs to fight against ML. After interviewing representatives of the three largest commercial banks, the assessment team was told of only one instance where ML or TF was suspected, which involved a branch of one of those banks located outside of Rwanda.

101. Although regulated financial institutions outside of the commercial banking system appear not yet to have implemented any specific preventive measures, the risk of ML and FT would appear to be relatively low. The development bank is state-owned and restricted in its activities to making loans for state-sanctioned development purposes, and the state-owned mortgage bank is both state-controlled and small in size. The cooperative and micro-credit institutions deal in very small sums and do not appear to pose a significant ML or TF risk.

102. The existence of exchange regulations in Rwanda not only limits the use of bureaux de change for ML and FT purposes, but also limits generally ML and FT risk.[16] Money transfer services are only allowed to operate through licensed banks, with only Moneygram and Western Union offering these services. The assessment team was informed that there were no substantial informal money transfer systems.

[16] Exchange regulations limit foreign exchange purchases to bureaux de change and banks. There is a general limit on foreign exchange purchases of US$500 per transaction for a total of US$1,000 per month per physical or legal person, with purchases requiring the presentation of a Rwanda identity card or foreign passport. The purchase and transfer of foreign exchange for both current and capital transactions in excess of the above limits require documentation on the identity of the parties and justification for the transaction.

103. The NBR expressed its intention to issue an instruction (draft Instruction) in the near future to implement the two articles noted above that would apply to all institutions subject to NBR supervision. The draft Instruction requires financial institutions to adopt policies on customer due diligence and customer acceptance, maintenance of client documents, the reporting of suspicious transactions to the NBR, and internal programs to fight ML and FT. It meets all of the FATF preventive measure requirements as they apply to the persons supervised by the NBR except for FATF recommendation 14 with respect to protection from both criminal and civil liability for disclosure of information if they report suspicions in good faith to competent authorities. Such broad protection would require the passage of a law.

104. There are a number of reasons to believe that implementation of the instruction would achieve at least a minimum level of success. First, ML and TF risk are relatively low; second, the financial sector is small, and the dominant commercial banking sector is already seeking to implement measures on its own to satisfy home supervisors and correspondent banks. Finally, the NBR is well organized and professionally (if somewhat under) staffed.

105. A regulatory body for insurance sector in Rwanda (the National Insurance Commission (CNA)) has recently been created, but it is not yet up and running and has not yet contemplated issuing any AML/CFT rules. However, the sector is quite small and largely limited to property and casualty. While this may change in the future, the insurance industry does not currently appear to pose any significant ML or TF threat.

106. Rwanda does not have a stock exchange or licensed securities broker-dealers.

Preventive measures-designated nonfinancial businesses and professions

107. No DNFBP would be covered by the draft Instruction. Rwanda produces no precious metals or gems, and there did not appear to be a significant retail jewelry sector. The legal profession in Rwanda consists of advocates and notaries, which do not typically serve in an investment advisory capacity or act as financial intermediaries for clients. While this sector does not appear to be susceptible to ML and TF, law association officials seemed amenable to considering adding preventive measures to their own self-regulatory guidelines.

108. The Rwandese accounting sector is very small and is primarily limited to providing accounting services only. The assessment mission was informed by sector representatives that the small number of Rwandese companies with a sizable turnover have predictable cash flows and would be very difficult to use as laundering vehicles. Any unusually large transactions would stand out immediately.

109. Rwanda does not currently have any casinos, real estate agents, or trust and company service providers.

Legal persons and arrangements and nonprofit organizations

110. Companies (and other entities with legal personality) require registration at the local court, which involves the listing of directors/managing partner and other persons that can act

on behalf of the legal entity. Companies must keep a shareholder register. There are currently relatively few private sector companies operating in Rwanda, and any lack of transparency in this sector does not currently appear to present a significant ML and TF risk.

111. There are a large number of not-for-profit organizations (NPOs) operating in Rwanda, which are all required to obtain a preliminary permit before they can commence work. The application for the permit must include the names of the founders and a plan of action, including the way the NPO intends to finance its operations. Having obtained approval, the Ministry of Justice can grant the NPO legal personality. Approval must be renewed annually; requirements for renewal include a full report on its operations, including a financial statement. It would appear that scrutiny over NPOs is not insignificant, and while not necessarily related to ML and TF, the sector appears to be subject to significant oversight.

National and international cooperation

112. Cooperation in criminal matters among the police force, customs, and the NBR appear to be good. The NBR cooperates closely with the financial crimes unit of the police, and a member of that unit liaises directly with the NBR through an office located at the NBR.

113. As yet, Rwanda has no comprehensive legal framework for international cooperation. In the past Rwanda has cooperated internationally in penal matters on an ad-hoc, case-by-case basis. According to the authorities, when receiving a request for legal assistance the Public Prosecutor can respond and do whatever is requested. Because ML as such is not a crime under Rwandese law, Rwanda would try to cooperate on the basis of complicity with the predicate offence.

114. Rwanda is a party to the 1988 Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention), the 1999 International Convention for the Suppression of the Financing of Terrorism (the ICSFT) the 2000 Convention against Transnational Organized Crime (the Palermo Convention) and the 1999 Convention of the Organization of African Unity on the Prevention and Combating of Terrorism. However, the terms of these conventions that involve international cooperation have not been implemented in national law. Nevertheless, the authorities indicated that the confiscation provisions of the Vienna Convention and the Palermo Convention can be applied directly pursuant to article 190 of the Constitution. However, given the fact that most of the terms of the aforementioned treaties amount to simply imposing obligations on the parties (“Each State shall adopt measures that…”) it is unclear how article 190 could resolve this.

115. Rwanda has extradition treaties with its neighboring countries (Uganda, Tanzania, Kenya, Burundi, and the DRC), whose main purpose is to secure the extradition of persons suspected of genocide. The constitution prohibits Rwanda from extraditing its own nationals, but the authorities indicated that if a state were to make such a request the Rwandese authorities would always investigate and prosecute the case themselves.

116. Rwanda has requested banks to keep apprised of the list of persons identified by the Security Counsel as terrorists and to report immediately to the NBR any customers on that list. There have been no cases of any such reports.

117. The NBR cooperates with foreign supervisors, including by giving relevant account data, on condition of reciprocity and confidentiality of the information provided.

Summary assessment against the FATF recommendations

118. The AML/CFT system in Rwanda is still at an early stage of development. The criminal system specific to ML and TF is not yet in existence, and the preventive system has not yet gone into effect. Therefore, substantial reform needs to be implemented in order to bring the AML/CFT system in line with international standards. Nevertheless, because of foreign exchange controls, general law enforcement, border controls, and efforts by commercial banks to implement AML/CFT policies, the risk of ML and TF in Rwanda appears to be low. The implementation of a draft instruction on preventive measures, which is expected soon, should materially improve the AML/CFT system. The enactment and implementation of a comprehensive AML/CFT law, expected within the next few years, would still, be required to bring Rwanda largely into compliance with the FATF 40 + 9.

Table 4. Recommended Action Plan to Improve Compliance with the FATF Recommendations

Subject	Recommended Action (listed in order of priority)
General	Adopt a general preventive AML law Issue and implement the draft instruction as soon as possible
Legal System and Related Institutional Measures	
Criminalization of Money Laundering (R.1 & 2)	Criminalize ML (beyond the current law on receiving stolen property) to include laundering of all criminal proceeds (beyond the current law on proceeds of corruption). The police and the prosecution should become aware of the offence, its scope and the possibilities for its application.
Criminalization of Terrorist Financing (SR.II)	Terrorist financing should be specifically criminalized.
Confiscation, freezing and seizing of proceeds of crime (R.3)	Expand ML confiscation provisions to cover direct and indirect proceeds of all laundering, and to include instrumentalities both used and intended for use for ML and TF. They should specifically allow for equal value confiscation. Introduce a framework for identification and tracing powers. Seizure provisions as conservatory measure should be adequate to cover all circumstances where confiscation is possible.
Freezing of funds used for terrorist financing (SR.III)	TF confiscation provisions should be introduced. Introduce a framework for identifying, tracing and freezing TF assets. Set up mechanisms for immediate response to relevant UN resolutions.

Subject	Recommended Action (listed in order of priority)
The Financial Intelligence Unit and its functions (R.26, 30 & 32)	Establish an FIU with appropriate powers and capacity to implement them. The FIU should: set out form and reporting method; setup a framework that meets training needs and requirements for reporting persons; collect, hold, analyze AML/CFT statistics, and produce typologies and other reports. Once operational, the FIU should apply for Egmont membership and adhere to and its Principles.
Law enforcement, prosecution and other competent authorities (R.27, 28, 30 & 32)	Provide appropriate training for law enforcement and prosecution to acquire the necessary level of skill and know-how in AML/CFT matters. Maintain law enforcement human resources with high integrity qualification at a level adequate to cope with the expected increase of investigations and prosecutions in ML/FT cases. The postponed seizure (controlled delivery) should be formally regulated as special investigative technique. Keep statistics on law enforcement results to assess the system's effectiveness.
Preventive Measures – Financial Institutions	
Customer due diligence, including enhanced or reduced measures (R.5 to 8)	Extend CDD requirements for NBR-regulated FIs to insurance providers. Ensure coordination on CDD policies through consultations between the NBR and the CNA. NBR and the CNA should conduct an analysis to identify customers and profiles with high and low risk for ML. Authorities should issue CDD guidance in accordance with conclusions.
Third parties and introduced business (R.9)	To address future developments the possibility of making use of identification performed by other service providers should be in the law.
Record keeping and wire transfer rules (R.10 & SR.VII)	Require institutions to maintain records of clients and transactions for five years.
Monitoring of transactions and relationships (R.11 & 21)	Extend monitoring requirements for NBR-regulated FIs to insurance providers. Ensure coordination on monitoring policies through consultations between the NBR and the CNA. NBR and the CNA should conduct analysis to identify transactions with high and low risk for ML. Authorities should issue monitoring guidance in accordance with conclusions.
Suspicious transaction reports and other reporting (R.13-14, 19, 25 & SR.IV)	Extend reporting requirements for NBR-regulated FIs to insurance providers. Ensure coordination on reporting policies through consultations between the NBR and the CNA. Introduce criminal and civil penalties for tipping off. Enact protection from both criminal and civil liability for disclosure of information if suspicions are reported in good faith.
Internal controls, compliance, audit and foreign branches (R.15 & 22)	NBR and the CNA should provide details on appropriate standards for FIs when hiring employees.
The supervisory and oversight system - competent authorities and SROs (R. 17, 23, 29 & 30).	NBR and CNA to develop capacity to supervise implementation of the draft Instruction, by creating a supervisory methodology, training supervisors, designing a compliance officer training program, and beginning a pilot program of assessments. Establish a sanctioning regime for non-compliance with AML/CFT obligations by the reporting entities, applicable both to natural and to legal persons.

Subject	Recommended Action (listed in order of priority)
Financial institutions - market entry and ownership/control (R.23)	Licensing procedures in the insurance sector should make explicit reference to integrity and fit and proper standards.
AML/CFT Guidelines (R.25)	See recommendations regarding issuance of guidance on CDD and monitoring above.
Ongoing supervision and monitoring (R.23, 29 & 32)	See recommendations for the supervision above.
Preventive Measures –Non-Financial Businesses and Professions	
Customer due diligence and record-keeping (R.12)	Introduce CDD and record-keeping requirements for dealers in precious metals and stones, lawyers, notaries, and auditors in the instances provided in FATF Recommendation 14. Coordination should be ensured through consultations by supervisory/SRO authorities and the NBR and CNA.
Monitoring of transactions and relationships (R.12 & 16)	Introduce monitoring requirements for dealers in precious metals and stones, lawyers, notaries, and auditors in the instances provided in FATF Recommendation 14. Coordination should be ensured through consultations by the supervisory/SRO authorities and the NBR and the CNA.
Suspicious transaction reporting (R.16)	Introduce reporting requirements for dealers in precious metals and stones, lawyers, notaries, and auditors in the instances provided in FATF Recommendation 14, and put in place adequate safeguards when imposing reporting obligations on lawyers, notaries and accountants. Coordination should be ensured through consultations by the supervisory/SRO authorities and the NBR and the CNA.
Internal controls, compliance and audit (R.16)	Obligations should include adoption of adequate internal controls and compliance measures, including audits.
Regulation, supervision and monitoring (R.17, 24-25)	Designate authorities for ensuring compliance with rules by dealers in precious metals and stones and auditors, and develop procedures for ensuring compliance.
Other designated non-financial businesses (R.20)	Design policies and measures to encourage less reliance on cash transactions.
Legal Persons and Arrangements & Non-Profit Organizations	
Legal Persons – Access to beneficial ownership and control information (R.33)	Automate the data management system of the registrar of companies to allow easy cross-checks and updating.
Nonprofit organizations (SR.VIII)	In supervising NGOs, authorities should specifically consider ML and TF issues.
National and International Co-operation	
National co-operation and coordination (R.31)	Create regulated gateways between FIU, law enforcement agencies and supervisors for cooperation and coordination at operational and at policy level.
The Conventions and UN Special Resolutions (R.35 & SR.I)	Introduce into domestic law the obligations under the Vienna Convention, the ICSFT, the Palermo Convention, the Convention of the Organization of African Unity on Prevention and CFT, and Resolution 1373.

Subject	Recommended Action (listed in order of priority)
Mutual Legal Assistance (R.32, 36-38, SR.V)	Adopt a framework for mutual legal assistance that guarantees consistency and efficiency of cooperation. Establish rules on freezing, seizing and confiscation.
Extradition (R.32, 37 & 39, & SR.V)	Ensure ML/TF is a ground for extradition. Maintain thorough data and statistics on extradition requests and disposal.
Other Forms of Co-operation (R.32 & 40, & SR.V)	FIU to enter into cooperative arrangements (MOUs or reciprocity), for information sharing and assistance in ML/FT FIU enquiries. Maintain comprehensive statistics to monitor performance of the cooperation. NBR and CNA should conclude memoranda of agreement on cross-border cooperation with jurisdictions of parent FIs and other relevant jurisdictions.

Authorities' response

119. The authorities are in agreement with the assessment. They indicated that a draft AML/CFT law should be submitted to Parliament in September 2005. The authorities also indicated that they were planning to sign in July 2005 a draft Instruction to implement two articles of the Banking Law (Law no 8/99 of June 18, 1999) relating to preventive measures (Articles 16.2 and 78) .