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***Financial Sector Development Program (FSDP):  
The Case of Rwanda***

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# **Financial sector Development program (FSDP): The case of Rwanda**

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## **Introduction:**

The strong relationship between financial sector development and economic growth is no longer debatable in my opinion. Even if it still was, there is consensus on the necessity of a well functioning financial system to reduce information asymmetry and transaction costs between savers and investors diversify risks and enhance efficient intermediation by allocating resources in the most efficient way. In doing so, a well functioning financial sector will lead to rapid accumulation of physical and human capital, enhance technological innovation and therefore lead to economic growth and poverty reduction. Despite all these well known attributes, well functioning financial sectors still elude most of sub-Saharan Africa and past financial sector reforms have only had very limited success.

My intention is not to review the rich literature on financial sector reforms; this has been well handled by the many professionals in this room. I was requested to speak about my experience in financial sector reform in Rwanda. Given that we have carried out rigorous reforms during the past 13years, I agreed with Mark that I will limit myself to the one set of comprehensive reforms, the Financial Sector Development Program, FSDP, and talk more on the process than on the content. I will therefore briefly give the rationale behind the recently launched FSDP in Rwanda, its scope, our approach to the reform process, and implementation progress to date.

I wish to put a caveat here; while there have been some achievements thus far, we are cautiously optimistic because it is pretty much work in progress. Implementation has just begun and many challenges still remain, we can only progressively evaluate its impact as we go along.

## **The Rationale for Financial Sector Development Program**

In the last decade, Rwanda like most other countries in sub-Saharan Africa has religiously followed the economic liberalization program, privatized the financial sector to reduce financial repression, encourage market determined prices of financial services, encourage entry of international players and enhance market competition. In 1999 the National Bank of Rwanda Act ( ie The Rwanda Central Bank Act) was revised to grant it independence to formulate and implement monetary policy and ensure financial sector stability.

In addition, the Central Bank's supervisory capacity was strengthened to enhance regulatory frameworks, reduce regulatory forbearance, ensure market discipline and comply with the Basel Principles of effective supervision.

However, despite of all the reforms, the Rwandan authorities recognized that the financial sector's ability to play its role of mobilizing savings, conducting effective intermediation, and financing its ambitious economic reform agenda was still far from achievable.

The authorities invited the joint World Bank/ IMF Financial Sector Assessment Program (FSAP) mission to carry out a diagnostic of the sector and make recommendations for further reforms.

The conclusion of the 2005 FSAP report not surprisingly describes the Rwandan financial sector as 'narrow, shallow with an oligopolistic banking sector and very low penetration of insurance services as well as undiversified financial products'. The FSAP further recognized, wide interest rate spreads, poor savings rate, scarcity of long term capital, unregulated pension and insurance sectors and a malfunctioning payment system.

In the context of addressing the weaknesses raised in the FSAP, and in line with Rwanda' Vision 2020, the long term vision for the development of our country, the Government launched the Financial Sector Development Program, FSDP in 2006.

The overarching vision of the FSDP is; ***“To develop a stable and sound financial sector that is sufficiently deep and broad, capable of efficiently mobilising and allocating resources to address the development needs of the economy and reduce poverty”***.

The Government of Rwanda recognises the importance of the financial sector and has made the FSDP one of the key components of the Growth flagship in its Economic Development and Poverty Reduction Strategy, EDPRS, the social -economic development agenda for 2008-12.

## **The Scope of the Financial Sector Development Program;**

The scope of FSDP was to address weaknesses in four areas; access to finance, capital market development, regulation of non-bank financial Institutions, NBFIs, and Payment systems.

Access to banking and other financial services outside Kigali and other major towns is still very limited. In 2005, the combined branch network of the 7 commercial banks was only 38 (it has since grown to 40). In terms of business, commercial banks accounted for about 75% of total deposits and loans yet only about 10% in terms of customers. A network of cooperative and credit union, Union de Banque Populaire du Rwanda, UBPR, with a nation-wide outreach of 145 (have since consolidated to 133) savings and credit outlets, as well as other MFI accounted for 90% of customers but only 25% of total deposits and loans.

In addition, MFIs which should normally play a significant role in bridging this gap were still financially weak, lacked adequate financial management systems, and had weak internal controls and poor governance structures. Clearly that needed to be addressed.

Rwanda lacked long term capital and market-based debt or equity products essential for its economic development strategy. While the banking sector was excessively liquid, the funds were short-term in nature. As a result, mortgages and investment projects were financed on very short maturity terms of around 5 years. This weakness was exacerbated by lack of efficient mechanisms for banks to transform the long term assets on their books into liquid funds. Moreover, the market lacked an interest rate yield curve to be able to price securities.

Non-bank financial institutions that are key players in the deepening and broadening of capital markets needed to be reformed and sufficiently regulated to encourage, competition, innovation and market discipline.

The Rwandan authorities recognized that an efficient payment system is an essential component of the financial sector infrastructure. The FSDP would seek to develop an efficient, secure and technology-based payment system to facilitate other growing economic sectors like trade and tourism. In addition, the authorities believed that an appropriate payment system infrastructure is

an essential tool for enhancing financial access in the most cost effective way.

The FSDP was therefore intended to achieve 4 specific objectives;

First, the FSDP intended to enhance access and affordability of banking and other financial services; by developing a strong, efficient, and competitive banking sector offering a diversified array of financial products and services. This included support for the development and broad outreach of a healthy, well regulated and professionally managed microfinance sector as a tool to extend financial services to the un-banked and contribute to poverty reduction.

Second, FSDP intended to enhance savings mobilisation by creating the appropriate environment, developing institutions and fostering market incentives for the development of long-term financial instruments and an efficient capital market

Third, FSDP aimed at developing an appropriate policy, legal and regulatory framework for the NBFIs

Fourth, FSDP intended to organise and modernise the National Payment system.

### **Our approach to the process of designing the program;**

I will briefly describe 6 elements in our approach which I believe have contributed significantly to the realization of the process, particularly to the “buy-in” of key stakeholders.

- 1) Setting the stage for the financial sector reform process
- 2) Assigning responsibilities clearly
- 3) Ensuring widespread ownership and participation
- 4) Basing a comprehensive set of reforms and action plans on an integrated strategy.
- 5) Seeking high level endorsement of the entire strategy and
- 6) Effective implementation

## **1. Setting the stage for the financial sector reform process**

Probably the most important element that contributed to what we believe is a successful reform process to date was having a very clear overriding national objective which was, and still is shared by virtually all high-level Government officials and the vast majority of financial sector stakeholders from the private sector.

This overriding objective, as articulated in “Rwanda Vision 2020” statement, is to transform Rwanda into a middle income country as well as an economic trade and communications hub by the year 2020. This common vision underpinned our priorities and the positioning of the FSDP as one of the key priorities for the country’s medium term Economic Development and Poverty Reduction Strategy, EDPRS, clearly underscores that.

In addition, the diagnosis by the joint World Bank/IMF FSAP mission of 2005 provided a deep and independent evaluation of the sector and recommended areas for reform.

## **2. Assigning responsibilities clearly.**

Government designated the BNR, the central bank which has a deeper understanding of financial sector issues, more technical in orientation and with a better set of skills, less encumbered by civil service and bureaucratic constraints, and relatively independent, to lead the process.

With the support of FIRST Initiative, the central bank, recruited a team of independent expatriate technical experts whose responsibility was to assist in designing a financial sector reform program that would effectively assist Rwanda in achieving its 2020 objective.

We selected a team with a leader who had broad experience in most financial sector arenas in developing countries and individual experts in each of the five identified priority areas, i.e., banking and access to credit, housing finance, capital markets, pensions and insurance, and payments systems. The team was able to adhere to our original schedule of having an agreed financial sector reform program by November 2006. It was strengthened by periodic assistance from a World Bank and IMF staff members both of whom were already working on Rwanda’s financial sector and had participated in the FSAP study. Their knowledge of financial sector issues and the Rwanda financial sector in particular was an invaluable input to the process.

### **3. Ensuring widespread ownership and participation**

In retrospect, I think that the approach we followed for ensuring widespread ownership and participation in the financial sector reform process was the second most important contributing element.

The national Steering Committee, SC, which I chaired, was representative of all major stakeholders in key financial reform arenas and, inter alia, included the Secretary General of the Ministry of Finance, the Economic Advisor to the President, and CEOs from financial and non-financial private sector institutions. The eight member SC consulted widely with the sector players and reviewed the consultants' reports on a regular basis.

All members shared the overriding objective and they reacted according to the dual concern of ensuring the proposed reforms would achieve the overriding objective as well as considering how the proposed reforms would affect their own institutions.

The national SC was supported by 4 subcommittees, whose responsibilities were to interact and guide the experts in their respective areas. The subcommittees were composed of mid-level officials from most of the important institutions in each arena. All proposed reforms and actions were debated in detail in subcommittee meetings which were chaired by one of the SC members, and attended by at least one of the consultants.

The subcommittees created a two way communication mechanism,

First, they provided the consultants with deeper insights and understanding of the various issues and how proposed reforms would affect the stakeholder institutions;

Second, they informed key stakeholder institutions as to what reforms were being considered and ensuring an early 'buy-in' of the reforms by higher executives.

The participation of mid-level managers removed any misconception that the reforms are externally imposed to the implementing institutions thus increased 'buy-in' by all levels of staff.



After the overall financial sector program design was largely in place, it was presented and debated in a one- day workshop consisting of about 150 key stakeholders, the bulk of them from the private sector. It was interesting to note that, during that question and answer session, several members of the national steering committee who attended made reference to “our strategy” rather than to “the consultants’ proposed strategy”. At the level of each individual institution the proposed reforms had become ‘demand-driven’ as opposed to being seen as pushed by either the consultants or the Steering Committee.

Presumably, this “buy-in” was a result of their participation throughout the design stage. This is particularly important because it signified commitment to implement the various actions in the FSDP concerning their organizations.

#### **4. Basing a comprehensive set of reforms and action program on a broad integrated strategy**

Rwanda needed a comprehensive and integrated financial sector strategy, designed to further its stated objective, not a shopping list of specific reforms in specified financial sector sub-arenas.

Many elements in the program are interlinked and interdependent; as a result, we believe the attention and dialogue has focused more on the “forest”,( i.e., the overall program and its impact,) than on the “trees”, i.e., the individual actions that are needed to implement the policy reform.

This has helped to create a stronger more unified constituency in support of the overall financial sector reform package and its objectives than if we had focused primarily on the individual elements.

A number of the individual policies within the reform program could have created lightning rods to attract formidable opposition but, for the most part, did not, e.g., some of the sensitive issues included;

- i) Transforming the huge cooperative bank network into a de facto commercial bank;
- ii) Increasing private ownership in a development bank
- iii) Transferring responsibility for supervising the insurance industry from a National Insurance Commission to the central bank; and
- iv) Assigning responsibility for supervision of the previously unsupervised national pension fund to the central bank.

I believe that any potential opposition to these reforms was dissipated by having a shared objective among key stakeholders as well as a shared view that the overall financial sector reform program would further that objective.

## **5. Seeking high level endorsement of the entire strategy**

The Governor and I provided several briefings on the key issues and recommended reforms to the President of the Republic during our periodic economic briefing sessions with him. As a result, he became fairly familiar with the key reform recommendations and the reasons for them, well before they were formally presented.

The Minister of Finance being represented on the SC by his Secretary General was on board from the onset. The Steering committee prepared and presented to Cabinet for its approval all elements of the reform program that had policy implications.

This Cabinet approval and its endorsement of the entire program, together with the participative process and broad agreement among the key stakeholders on the reform agenda, created a powerful mandate and launching pad for implementing of FSDP.

## **6. Effective Implementation:**

Once all the stakeholders were in agreement on ‘what’ the next huddle was ‘how’. Implementation is terribly important as no financial sector reform program and indeed no other reform program would be successful, if that task is not accomplished in an efficient, timely and high quality manner. For us to make it happen we need qualified people who are in short supply in Rwanda, and to build institutions that are capable carrying out these reforms. Most of the actions in program required substantial funding, it was therefore important to get our development partners on board from the onset. Our approach to implementation included the following:

In order to maintain the momentum for implementation, the mandate of the national SC was extended to include implementation oversight.

Effective implementation oversight also required the establishment of a project management unit within the Ministry of Finance to coordinate the

process, monitor compliance by each of the 13 implementing institutions with the agreed milestones and periodically report to the SC.

Implementation also required each of the 13 institutions to assign an individual from within that institution with clear responsibility for implementation and act as a focal point for coordination with the project management unit.

In addition, involving one of the consultants who participated in our financial sector reform strategy to stay involved as advisor on a regular basis over the next two years will provide a quality assurance of the implementation process and give technical support to the project management unit

One of the challenges we faced once we had the FSDP approved was how to finance its implementation. Under the auspices of the World Bank Resident Representative in Kigali, a mini donor's round table was held where I presented the FSDP and its funding needs. I have to say that we received tremendous support from our development partners for both technical assistance and financial support. For example,

- We are in discussions with AfDB to fund the capital market development component
- DFID is funding the FinScope survey
- Dutch Cooperation offered Euro 4million as technical assistance (TA) to the restructuring of UBPR and help in merger with Rabo Bank
- Government of Rwanda funded the components regarding the implementation of the MFI policy
- FIRST Initiative which funded the design stage has approved further funding for some of the components, ( ie; quality assurance by the lead consultant, drafting of pension and unit trust law and the design of the ACH/RTGS business case for Rwanda)
- IFC is giving TA in development of credit bureau as well as EAC security market integration project.
- IMF has offered a long-term technical advisor to BNR on NBFIs supervision

- USAID offered a software FinA for financial sector reporting which we shall extend to cover MFI once it is fully operational
- US Treasury gave technical assistance in the development of government long term government securities.
- World Bank under the Competitiveness project is providing \$6million in the various components in the microfinance sector to enhance access to finance and in the payment system infrastructure

**Progress so far:**

We immediately embarked on the components that did not require any external technical or financial assistance or where it could be mobilized immediately. For example;

- Preparation of the legal and regulatory framework as well as creating the new institutions that will be needed to implement many of the actions
- The Central Bank Act was immediately amended to extend its mandate to include supervision of Non-bank Financial Institutions, NBFIs. Consequently a new Insurance Law has been submitted to Parliament and new supervisory instructions are being prepared by the BNR.
- Minimum capital of banks was raised from \$3million to \$10million and all the 7 commercial banks were in compliance by the 31<sup>st</sup> Dec deadline except one whose negotiations with an external investor will be completed by 15<sup>th</sup> February.
- UBPR has been transformed and issued a full commercial bank license.
- The Capital market advisory council was put in place to prepare the legal, regulatory and institutional framework for a securities Over-The-Counter, OTC, market that will eventually trade in shares as we prepare ground for an East African integrated regional stock market. So far primary issuance of government securities with 2year maturity was oversubscribed and a 5- year Bond is in the offing. One corporate bond with 10 year maturity has been issued to the market on private placement and secondary trading for both classes of bonds has commenced.
- We have initiated a FinScope survey to get baseline data on financial access, particularly on the demand side.

- A microfinance policy and strategy was launched as a sector-wide framework to provide government, MFI's, development partners, the private sector and civil society with the appropriate tools and roadmap for realization of the Government's vision of extending financial services to the rural poor.
- SIMTEL, an inter-bank company managing a card system has been revamped with entry into its shareholding of a competent strategic partner to drive the business.

These are some of the immediate accomplishments from the reform, it is however work-in-progress and its success will be progressively evaluated.

#### Conclusion:

It's too soon to measure the full impact of FSDP because its implementation has just begun. It may even be difficult in future to measure its isolated impact on the financial sector when you control for all the other reforms prior to FSDP. However, I believe FSDP will achieve its intended objective and change the Rwandan financial landscape because;

First, it was designed within the broader framework of Rwanda's socio-economic reform agenda and following an in-depth analysis of the sector by the joint World Bank/ IMF FSAP mission.

Second, it is more comprehensive and forward-looking as opposed to earlier piecemeal reforms

Third, the participative nature of the design process ensured an overwhelming 'buy-in' by all stakeholders as evidenced by the implementation progress so far, the enthusiasm and commitment by the various implementing institutions as well as support from our development partners to fund it.

Fourth, there is political will on the part of Rwanda government to do what it takes to implement it successfully. While we are very happy with the process and the product so far, it is nonetheless 'work-in-progress' and a 'living document' that will be progressively evaluated and improved.