# 5
# Rwanda
## Running Without Legs

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### Introduction

Since the 1994 genocide, the Rwandan Patriotic Front (RPF) government has led the country through a remarkable economic recovery with annual GDP growth rates exceeding 6 per cent in most years. The RPF government's economic strategy is to develop a service-based economy, which includes making Kigali (its capital) a hub of various kinds—from tourism to ICT—and also for finance. This differentiates Rwanda from the East Asian developmental states and another aspiring African developmental state (Ethiopia) where financial sectors have been largely under government control (or owned by local nationals) (Oqubay, 2015; Wade, 1990). With the aim of becoming a financial sector hub, the RPF government has transformed its financial sector—liberalizing it and recently committing to rapidly adopt and implement Basel II and III standards. Since Rwanda's financial sector remains largely underdeveloped, the government's exuberance for adopting and implementing the most recent international banking standards seems out of touch with the capacities and status of the country's financial sector, also contradicting the aim of becoming a developmental state. In its position as a small country with limited resources, the RPF government has become an uncritical standard-taker in its financial sector. The government's adoption of Basel standards signals a commitment to experimentation but highlights the prioritization of meeting (what they perceive as) best practices ahead of dealing with domestic contextual realities.

This chapter argues that the RPF government's adoption and proposed implementation of Basel banking standards is 'policy-driven' convergence. Rwandan regulators have limited autonomy and leadership. Rwandan regulators support Basel adoption because it aligns with a broader economic objective (becoming a financial sector hub). Yet unlike dynamics in Ghana (another example of policy-driven convergence), the goal of implementing Basel standards is not a matter of political contention given that the dominant party (RPF) enjoys relatively uncontested authority. Rwanda's economic leadership (the president and senior ministers) drives Basel implementation because it is perceived to be an

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instrument to achieve larger strategic goals: meeting global best practices, becoming a financial hub, reducing risk in the financial sector, and encouraging East African Community (EAC) harmonization and integration. The prevailing attitude among regulators is to meet standards first and then 'adapt to challenges later'.[1] For Rwanda, this highlights a conflicted development strategy where leadership sets priorities for the economy and feedback is rarely acted upon until failure is proven to have occurred.

For the broader comparative study of Basel adoption in developing countries, Rwanda presents a surprising case among aspiring developmental states in its policy actions in the financial sector. Even though the policy lending that usually characterizes developmental states generates incentives for countries to divergence from international financial standards, in Rwanda incentives to converge outweigh incentives to diverge. Among instances of 'policy-driven' convergence, the Rwanda case demonstrates the difficulties associated with Basel implementation when few actors are placed in a position to contest strategic priorities set by the economic leadership.

Research for this chapter was conducted in June 2017. Forty-six interviews were conducted in Kigali with government officials including the National Bank of Rwanda (BNR)—the financial sector regulatory agency, representatives from all commercial banks (including risk managers), donors (including the World Bank and IMF), and financial sector consultants. This chapter also builds on the author's previous fieldwork experience in Rwanda, which dates back to 2011. It begins with an examination of the political economy of Rwanda's banking sector. It then discusses the evolution of Basel adoption and implementation in Rwanda, followed by a discussion of the political economy of Basel adoption in Rwanda. The chapter concludes by highlighting the impact of policy-driven Basel adoption in Rwanda, describing how target-setting among economic leadership has exposed the weaknesses of the country's financial sector and has imposed limits on the country's developmentalist ambitions.

## The political economy of the post-1994 banking sector in Rwanda

Rwanda's financial sector has grown substantially since 1994 and in recent years it has been among the fastest-growing sectors in the country (Behuria and Goodfellow, 2017). Rwanda's development strategy—VISION 2020—prioritized the creation of a knowledge-based economy, with the liberalization of the financial sector perceived to be a foundation on which services-based development

[1] Interview, BNR regulator, Kigali, June 2017.

would thrive (Government of Rwanda, 2000). In November 2015, the Rwandan government announced its intention to rapidly and concurrently adopt and implement aspects of Basel II and III banking standards. This occurred at a time when Rwanda's financial sector expanded to eleven commercial banks operating in Rwanda, four microfinance banks, one development bank, and one cooperative bank, as of July 2017. The banking system comprises the largest share of financial sector assets at 66.3 per cent as of June 2016 (National Bank of Rwanda, 2016). Pensions, microfinance institutions, and Savings and Credit Cooperatives contribute the remaining banking sector assets. Though the financial sector remains shallow and underdeveloped, it has expanded considerably from its pre-1994 size (Table 5.1).

Before 1994, there were three active banks in Rwanda: Banque Commerciale du Rwanda (BCR), Bank of Kigali (BK), and Banque Continentale Africaine du Rwanda (BACAR). Union des Banques Populaires du Rwanda later became Banque Populaire du Rwanda (BPR). After the genocide, the government liberalized the commercial banking sector and licensed two new commercial banks—Bank of Commerce, Development and Industry (BCDI) and Banque à la Confiance d'Or (BANCOR). Local Rwandans—closely tied to the RPF—became lead investors in these banks. In 1999, more than forty Rwandan investors and state-owned institutions (which owned a minority share) collectively established a new bank—Cogebanque.

In the early and mid-2000s, elite frictions within the RPF became public (Behuria, 2016; Reyntjens, 2013). During this phase, prominent Rwandan officials in private commercial banks were accused of embezzling funds. These events, and frictions between prominent RPF elites (and pressure from international financial institutions), contributed to decisions to liberalize the financial sector. During this period, commercial banks came close to bankruptcy and senior RPF

**Table 5.1** Rwanda: key indicators

| **Rwanda** | |
|---|---|
| **GDP per capita (current US$, 2017)** | 784 |
| **Bank assets (current US$)** | 2.05 bn |
| **Bank assets (% of GDP)** | 24.2 |
| **Stock market capitalization (% of GDP)** | Data not available |
| **Credit allocation to private sector (% of GDP)** | 21 |
| **Credit allocation to government (% of GDP)** | 4.4 |
| **Polity IV score (2017)** | –3 |

*Note*: All data is from 2016 unless otherwise indicated.

*Source*: FSI Database, IMF (2018); GDI Database, World Bank (2017); Polity IV (2014) leadership became increasingly worried about the security of the financial sector.[2] The government recognized its political vulnerability and the limited capabilities that had been associated with relying on domestic elites in the sector and decided to rely on foreign investment in commercial banking, believing that increased competition would secure the sector's growth. Yet through its state-owned bank (Bank of Kigali), the government chose to retain some control over the sector. Since state-, party-, and military-owned enterprises controlled a large share of the economy, the government also retained some control within the financial sector through operating as a large client for commercial banks. Thus, the government did not completely ignore the importance of some degree of state control of the financial sector but it had departed a great deal from the traditional role of the developmental state in the financial sector.

Today, Rwanda's commercial banking sector can be divided into four categories: a state-owned commercial bank (BK), a large international investor-owned commercial bank, several regional or pan-African bank subsidiaries, and one bank collectively owned by several Rwandan investors (*Cogebanque*). As of 2016, government-owned BK retained over 30 per cent of the market share of the domestic financial sector in several indicators including assets (34 per cent), net loans (38 per cent), customer deposits (37 per cent), and equity (39 per cent). Since 1994, the IMF and World Bank has often pressurized the Rwandan government to sell its stake in BK. Government officials have also considered selling shares to international banks or strategic investors.[3] In 2011, BK initiated an initial public offering of 62.5 million dollars on the Rwandan Stock Exchange (RSE).[4] Despite 45 per cent of BK shares remaining in 'free float' on the RSE, the government retains a majority shareholding in the bank in partnership with its institutional partner—the Rwanda Social Security Board (RSSB). Though BK operates as the only state-owned bank in the sector, its role as an instrument for developmental state objectives is unclear. It is often the bank used for strategic investments but it also has among the highest interest rates for loans across the sector. BK continues to be the most profitable and the largest bank operating in Rwanda. According to an I&M Bank official—among BK's largest domestic rivals—'BK is four times our balance sheet'.[5] Though BK dominates the sector, it is relatively small within the region and is barely within the top twenty banks operating in East Africa.[6]

Atlas Mara BPR is the only significant international investor operating in the sector. As of 2016, BPR was the third largest bank in the country (after I&M Bank).

[2] Interviews, BNR, Kigali, June 2017.

[3] Interviews, BNR, Ministry of Finance and Economic Planning (MINECOFIN) and BK, Kigali, June 2017.

[4] Currently, shares in four banks are listed on the RSE: BK, I&M, KCB, and Equity.

[5] Interview, I&M Bank, Kigali, June 2017.

[6] Interview, small bank, Kigali, June 2017.

In 2016, Bob Diamond and Ashish Thakkar's investment company—Atlas Mara—completed the purchase of 62 per cent of BPR's shares. This added to their existing presence in Rwanda since Atlas Mara bought the BRD's commercial bank in 2015.[7] Within Rwanda and elsewhere in Africa, Atlas Mara's investments have experienced some initial difficulties. The bank's cost-to-revenue ratio of over 95 per cent was the highest in the country (Mwai, 2017). Atlas Mara has recently imposed significant employment cuts and centralized most of its operations. Headcount has shrunk by 25 per cent in the last year.[8] A restructuring programme has been launched to improve profitability, reverse loss of market share, and shift the business to a more balanced retail and corporate customer base.[9] In 2017, the cost-to-revenue ratio had reduced to 80 per cent.[10] When Atlas Mara took over BPR, they 'had a big surprise with very large numbers of non-performing loans (NPLs). Currently, the bank's NPLs are 12.4 per cent and by the end of the year, the bank's target is to reduce it to 6 per cent (with the average across commercial banks about 5.6 per cent)'.[11]

Several regional banks also operate in Rwanda. Out of such banks, I&M Bank (formerly BCR) has the largest market share. Other regional banks include Equity, KCB, GT Bank, Access Bank, Commercial Bank of Africa, Crane Bank, and Ecobank. *Cogebanque* is the only commercial bank in which Rwandans own a majority share (outside BK).

In comparison to other case studies in the Navigating Global Banking Standards project, Rwanda is relatively unique. The composition of its commercial banking sector includes one large government-owned bank (BK) with most other banks operating in Rwanda as subsidiaries of larger regional or pan-African banks. Though the sector is liberalized, the government remains a significant actor—both through its ownership in the largest bank (BK) but also as the largest customer, with party- and military-owned enterprises remaining large recipients of loans. Though BK is very large within Rwanda, it is miniscule when compared to the size of the parent companies of local Rwandan subsidiaries. Thus, most commercial banks operating in Rwanda are better resourced with more access to capital and expertise than BK. The consequences of the adoption and implementation of Basel II and III banking standards will vary across these different banks and most commercial bank representatives were pessimistic, admitting difficulties associated with implementation in the short term.

[7] The BRD had established a commercial bank for a few years. After its sale, its role is restricted to that of a development bank.

[8] Interview, Atlas Mara BPR, Kigali, June 2017.

[9] Interview, Atlas Mara BPR, Kigali, June 2017.

[10] Interview, Atlas Mara BPR, Kigali, June 2017.

[11] Interview, Atlas Mara BPR, Kigali, June 2017.

## Rwanda's adoption and implementation of Basel banking standards

The RPF government has adopted a relatively conservative stance to banking regulation. This has been motivated by its desire to ensure financial sector stability, its position as a standard-taker in global banking regulation, and the hope that the implementation of global financial standards may contribute to making Kigali into a financial sector hub. Basel I standards were implemented in 1998. However, the Rwandan government was relatively slow with officially stating its intention to comply with Basel Core Principles (BCPs) or Basel II and III banking standards. Discussions of formally adopting Basel reforms began in the mid-2000s when the East African Community (EAC) argued for a common stance in relation to Basel standards. Despite limited discussions of formally adopting Basel II and III, Rwanda already complied with more than 80 per cent of BCPs and in some measures (like capital adequacy requirements), and Rwanda's financial standards were much higher than those required in Basel II (Enoch et al., 2015). In 2015, Rwanda was ranked among the most compliant countries in Africa (with regard to BCPs).

In the last two years, the RPF government has formally announced its intention to adopt and implement most Basel II and III requirements. In November 2015, the BNR issued a directive, which required parallel reporting of Basel II capital requirements. By 1 January 2018, all commercial banks in Rwanda had to be fully compliant with Basel II and III (although only elements of both will be part of the regulation). Initially, observers (Andrews et al., 2012) had argued that there would be minimal impact because of already existing conservative regulatory measures in Rwanda. However, the implementation of Basel standards is already forcing commercial banks to significantly alter their operations.

The ambitious adoption of Basel banking standards is even more surprising given the rapid changes that have occurred in the banking sector over the last two decades. After the 1994 genocide, the financial sector was in severe difficulties, with the fleeing members of the previous government stealing over 30 billion francs or two thirds of the monetary base, including cash from the BNR vaults (Addison et al., 2001). The post-1994 government perceived liberalization of the sector to be necessary for stabilizing the economy. Official BNR reports (National Bank of Rwanda, 2011) highlighted the 'direct control' of the financial system as a hindrance to growth. Liberalization of the financial sector and the introduction of a flexible exchange rate system were introduced in the context of three economic stabilization programmes, pushed through by the IMF and the World Bank—the Structural Adjustment Programme (1990), the Enhanced Structural Adjustment Facility-Poverty Reduction and Growth Facility (1998), and the Policy Support Instrument (2010).

**Table 5.2** Rwanda: adoption of Basel standards

| Basel component | Adoption | Implementation |
|---|---|---|
| **Basel I** | 1998 | 1998<br>Credit risk<br>No operational or market risk |
| **Basel II and Basel III** | November 2015 directive (Adoption)<br>January 2018 (Proposed implementation)<br>5/10 components (Basel II)<br>6/8 components (Basel III) | Standardized approach for market risk<br>Revised standardized approach for operational risk and capital buffers (including capital conservation buffer and domestic systemic important bank) |

Rwanda began adopting Basel I banking standards in 1998 (Table 5.2). Initially, Basel I was implemented with a focus on credit risk and there was limited attention to banking supervision, operational risk, and market risk. Since the Rwandan financial sector has a very limited range of products, market risk is marginal across commercial banks. An initial motive for adopting Basel banking standards was the decision to harmonize banking standards within the EAC. Within the EAC, Rwanda occupies a relatively unique position. Since Rwanda is land-locked and because it is a comparatively smaller country with a small market, the government perceives EAC integration as essential to access larger markets and to achieve its aim of becoming a services hub. President Kagame has been the leading champion of EAC integration in the region and government officials constantly highlight the importance of regional integration, arguing that 'we have to set an example for integration because without it, there are limits to our growth'.[12] Government officials see regional integration to be particularly significant in terms of the goal of becoming a financial sector hub. Their reasoning relied on two main factors, which they saw as the country's comparative advantage: leadership and domestic security.[13] Though most consultants doubt that such advantages could be enough to make Kigali a financial sector hub, government officials remain committed to the target.

In 1999, the Banking Supervision Department was created within BNR with the aim of streamlining and ensuring an efficient banking sector. The BNR Law of 1981 was revised by the Banks Act of 1999, with BNR issuing several prudential regulations. The regulatory level of commercial banks' share capital went up progressively from Rwf 100 Million to Rwf 300 million in 1995, to Rwf 1.5 billion in 1999 and to Rwf 5 billion in 2006. In 1999, the Rwanda Central Banking Act was

[12] Interview, BNR official, Kigali, June 2017.

[13] Interview, BNR official, Kigali, June 2017.

revised to grant BNR independence to formulate and implement monetary policy and ensure financial stability. The 1999 Act was 'strengthened to enhance regulatory frameworks, reduce regulatory forbearance, ensure market discipline and comply with the Basel principles of effective supervision' (Rusagara, 2008, p. 3). In 2003, IFRS-based accounting standards were introduced for the banking sector. In the same year, the CAR was increased from 8 to 10 per cent, the decrease of permissible deduction of accepted collateral from loan-loss provisions from 100 to 70 per cent, and the rules on insider lending, loan management, credit concentration, and the restructuring of the banking sector were strengthened.

To enable the central bank to focus on high-risk banks and high-risk areas in each bank, BNR adopted the Risk Based Supervision (RBS) framework in 2006. Adoption of RBS was to ensure compliance with and implementation of international best practices. A 2007 BNR Law and a 2008 Law on the Organization of Banking (LOB) have further strengthened the BNR's regulatory authority. Since the 2008 LOB was enacted, BNR dedicated time to ensuring all new regulations aligned with the law. During this period, several new banks entered the sector. As a result, new commercial banks hired several BNR officials—including risk managers. The extent of regulation became less of a problem compared to the limited capabilities within BNR since new employees had to be hired once trained employees were hired elsewhere.[14] In the late 2000s, all twelve of BNR's risk managers gave notice within a short space of time and even in 2017, two former BNR officials joined new commercial banks.[15] Consequently, retaining staff continues to pose a significant challenge for BNR.

The Rwandan government has also published two Financial Sector Development Program (FSDP) Strategies, which have been direct responses to two IMF Financial System Stability Assessment (FSAP) reports. After FSAP-1, in 2005, the government developed a strategic plan (2008–12) under FSDP-1. The FSAP-1 (IMF, 2005) recommended that the government take several actions to improve compliance with BCPs. One report (Andrews et al., 2012) claims that over 90 per cent of policy actions in FSDP 1 were completed. IMF (2005) highlighted several weaknesses in relation to enforcement, limited BNR staff, amending the CAR, strengthening regulations on lending, and harmonizing auditing and accounting standards to international levels. In 2007/8, Rwanda's banking sector suffered a crisis, forcing BNR to redesign its prudential regulations on liquidity risk management (Sanya et al., 2012). BNR regulators highlight that during this period, there was a 'liquidity crunch'.[16] This liquidity crisis continued until at least 2010, occurring at a time when several new banks began operations in Rwanda.

[14] Interview, commercial bank risk manager, Kigali, June 2017.

[15] Interview, commercial bank, Kigali, June 2017.

[16] Interview, BNR official, Kigali, June 2017.

BNR's banking supervision team 'lost all of their staff', further highlighting the skills shortage within the financial sector.[17]

After FSAP-2 was conducted, FSDP-2 developed a roadmap between 2014 and 2018 while also identifying 437 policy actions. FSAP-2 (IMF, 2011) highlighted that Rwanda's capital adequacy requirements conform to Basel I principles. Though the minimum capital adequacy requirement is 15 per cent in Rwanda, the BNR did not apply a capital adequacy charge for market risk (as of 2011). The IMF (2011) also found several weaknesses in Rwanda's banking sector reforms including the need to speed up the process of introducing prudential regulation on the basis of new laws, strengthening the framework for cross-border supervisory cooperation, increasing the frequency of on-site examinations for the largest banks, and ensuring BNR staff remained updated with the skills and supervisory methods expected of them in relation to new laws and regulations. After FSAP-2, BNR initiated new requirements in banking supervision within commercial banks, calling for the establishment of separate risk departments. This was a significant challenge as there were few bankers within Rwanda with such expertise. In 2012, across the financial sector, the National Skills Survey found that 'the financial services sector has a total skills gap of 6,312 labour units', with over 45 per cent of the gap comprising 'technicians' (Rwanda Development Board, 2012).

The decision to adopt and implement Basel II and III was taken after the FSAP-2 was published. At least in terms of capital adequacy requirements, the average among commercial banks operated above Basel 1 requirements. The capital adequacy ratio (CAR) in commercial banks stood at 13.7 per cent in 2006, 16.2 per cent in 2007, and 15.9 per cent in 2008 (National Bank of Rwanda, 2009). After 2010, Rwanda's CAR has stayed in excess of 20 per cent and is the highest in the region. Figure 5.1 illustrates the evolution of Rwanda's CAR and non-performing loans (NPLs). Commercial bank representatives and BNR officials both admitted that NPLs are much higher and vary significantly among banks, as compared to these official statistics. Atlas Mara BPR, for example, has much higher NPLs than most other banks.

In 2011, BNR required banks to hold core capital of at least 10 per cent of risk-weighted assets and total capital (core plus supplementary capital) of at least 15 per cent of risk-weighted assets. In 2016, several banking standards were above Basel II/III thresholds. For example, the leverage ratio increased at a rate of 1 per cent annually between 2014 and 2016—from 8 per cent to 10 per cent, which was significantly above Basel II/III thresholds (3 per cent) and BNR requirements (6 per cent). The key difference was the introduction of risk-weighting based on the external credit rating of the counterparty. But it was estimated that there would be 'minimal effect due to virtual absence of rated counterparties to the Rwandan banking system' (Andrews et al., 2012, p. 66).

[17] Interviews, Rwandan risk managers (government and commercial), Kigali, June 2017.

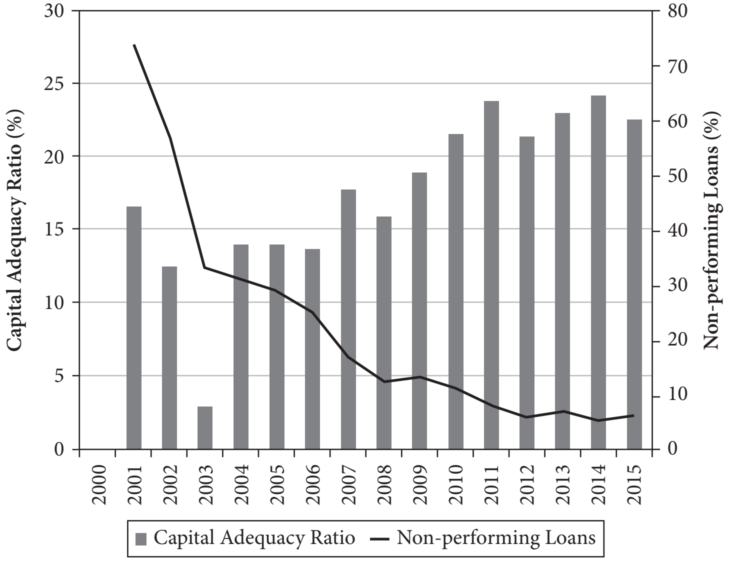

**Figure 5.1** Rwanda: capital adequacy ratios (CAR) and non-performing loans (NPLs).
*Source:* IMF (2018)

In 2013, consultations between economic leadership and BNR led to the establishment of a Basel steering committee, which included key BNR officials and three commercial bank risk managers (who were the most senior Rwandan regulators, two of whom had previously worked in BNR). Most decisions with regard to Basel II and III implementation have been taken after discussions with the committee. Commercial banks have been invited to take part in the consultation process. Though commercial bank representatives agreed that there was consultation, they complained that discussions were 'never reflected in the final document'.[18] The establishment of the Steering Committee was a response to ensure different stakeholders had a voice in Basel adoption and implementation while also ensuring the government made full use of the expertise within the financial sector (which had become concentrated in commercial banks).

BNR decided to adopt Basel II and III rapidly and concurrently. By the end of 2013, a draft of the regulatory framework was in place. In 2014, a kick-off event took place with all managing directors of commercial banks invited. In November 2015, a directive was issued, which required parallel reporting of Basel II capital requirements. At this time, regulators at commercial banks 'did not really know what to do' and there were 'capacity challenges'.[19] As part of the 2015 directive, BNR required banks to hold a minimum total capital of 12.5 per cent of total

[18] Interview, commercial bank, Kigali, June 2017.

[19] Interview, commercial bank and consultant, Kigali, June 2017.

risk-weighted assets and to hold 10 per cent of core capital to risk-weighted assets. Banks were also required to hold capital conservation buffers of 2.5 per cent. SIBs were obliged to keep additional systemic capital buffers of 1–3.5 per cent defined for different brackets (National Bank of Rwanda, 2016). As of 2017, it was not clear which banks would be categorized as SIBs (though BK, I&M, and Atlas Mara BPR said they expected to be named SIBs). Most older and medium-sized banks complained about the added burden that would be associated with the capital conservation buffer.[20] One banker said that the buffer would 'penalize all large banks in the sector and restrict attractiveness of the country. The return on equity in the region is already the lowest and it is nearly half of what it is in other East African countries'.[21] Figure 5.2 illustrates the evolution of return on assets (RoA) and return on equity (RoE) in Rwanda. According to respondents from commercial banks, these official statistics overestimate the RoE.[22] In Rwanda, the RoE has been particularly low because even in the fastest-growing sectors, investments have often not reaped profits. For example, in the high-growth tourism sector, there has been a danger of 'over-supply' in hotels with capacity utilization at

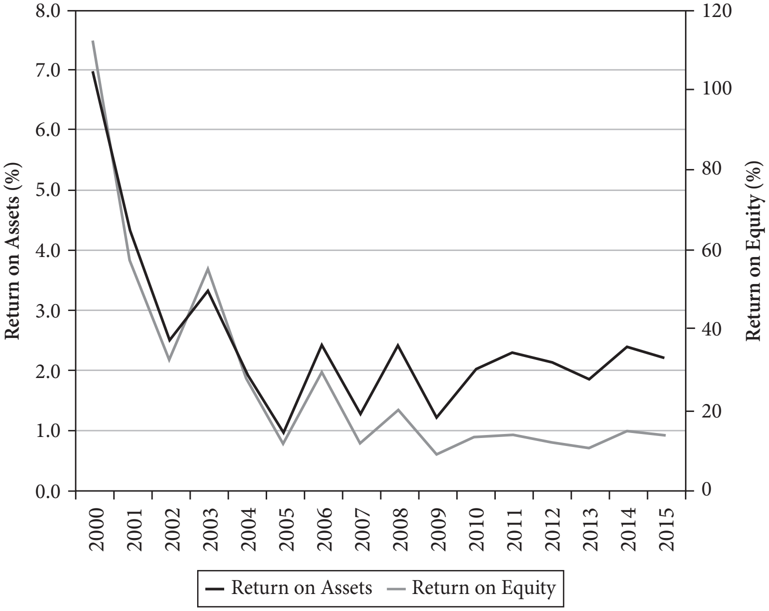

**Figure 5.2** Rwanda: rates of return on assets (RoA) and equity (RoE).
*Source:* Bankscope and Orbis Bank Focus, Bureau van Dijk, 2018

[20] Interviews, commercial banks, Kigali, June 2017.
[21] Interview, commercial bank, Kigali, June 2017.
[22] Interviews, commercial banks, Kigali, June 2017.

below 50 per cent (International Growth Centre, 2016). Over one hundred hotels shut down in Kigali between 2013 and 2015 (Gahigi, 2015).

Though Basel II and III implementation would require some changes to capital adequacy requirements, the FSAP-2 (Andrews et al., 2012) estimated that the effect would be minimal on commercial banks. To be Basel III compliant, Rwanda will retain the current 15 per cent total capital ratio (though the EAC agreed minimum standard is 14 per cent) (Government of Rwanda, 2013). Risk management may change significantly, as a result of Basel II and III implementation. 'Earlier, BNR was only concerned with credit risk. Now, there is more of an interest in operational risk and we don't have the systems or data for that in all the banks'.[23] However, for many banks, operational and market risk remain negligible and 'don't really affect' them.[24] Yet the impact will be uneven across commercial banks. For Atlas Mara BPR, which has large numbers of daily transactions, operation and market risk will have an impact.[25] One BNR regulator admitted that 'it may affect growth in lending but the question is how resilient commercial banks are in moving from credit risk to adding operational risk and market risk'.[26]

BNR has now adopted most aspects of Basel III standards with the exception of risk coverage (for counterparty credit risk) and requirements for global systemically important banks (as it has no such banks in its jurisdiction). To improve reporting procedures between commercial banks and the central bank, BNR is establishing an electronic data warehouse. In May 2017, the regulation was issued, although there was a lack of clarity about whether it would be in effect immediately or starting January 2018. There was also some confusion about how the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP) would be implemented across the financial sector. BNR officials said they were discussing how to implement ICAAPs in relation to risk exposure in the sector and highlighted the lack of skills within the country as a limitation.[27] Some commercial banks were worried about the way ICAAP would be computed. 'There is currently no framework for pillar 1 and my understanding is that there is no standardized framework worldwide for pillar 2. In particular, we are unsure of what parameters to use and there is a major challenge with non-quantitative risk types'.[28] One consultant doubted the feasibility of implementing ICAAP programmes.[29]

In February 2018—a month after all commercial banks had to be compliant with Basel II and III standards—BNR issued a directive, which stated that all banks would have to submit approved annual ICAAP and ILAAP documents for

[23] Interview, commercial bank, Kigali, June 2017.

[24] Interview, commercial bank, Kigali, June 2017.

[25] Interview, commercial bank, Kigali, June 2017.

[26] Interview, BNR, Kigali, June 2017.

[27] Interview, commercial bank, Kigali, June 2017.

[28] Interview, commercial bank, Kigali, June 2017.

[29] Interview, consultant, Kigali, June 2017.

review by March 2019, with larger banks having to prepare their first ICAAP and ILAAP documents by July 2018.

Some large banks (like BK and Atlas Mara BPR) were also worried about the implementation of IFRS 9, which all banks had to implement by January 2018. One banker said, 'the impact of IFRS 9 will change the landscape of the market. We have a lot of data constraints and segmentation issues. We aren't privy to high-level macrodata. This impacts how we construct our models. We also don't have good historical data'.[30]

Unlike in Ethiopia, the RPF government fails to question donor-led models in the financial sector and nearly every regulator and commercial banker in the country said that there were long-term benefits in enacting Basel reforms. Though scholarship (Gottschalk, 2010) has shown that Basel adoption is not necessarily the best way forward for late developing countries, such arguments have not gained traction with Rwandan banking regulators. The Rwandan government's uncritical stance towards Basel adoption can be interpreted both as a belief in such standards or ideological agreement with market-led reforms. Clearly, international consultants (employed by the IMF) have been influential in setting the parameters on which BNR's regulation would be judged. However, Rwandan bankers—individually and as a group—are detached from regional or international banking networks. There is significant turnover of BNR staff and though some remain involved in discussions of Basel implementation, BNR simply acts as an agency charged with implementing Basel.

Rwanda's policy-driven adoption of Basel banking standards has been ambitious and has progressed without acknowledging negative consequences. The RPF government has enacted such reforms, assuming that it may result in a more secure financial sector. Yet it may have the opposite effect with commercial banks worried about the effect it may have in the short term.

## The political economy of Basel adoption

Policy-driven Basel adoption in Rwanda follows closely in line with the project's analytical framework. BNR regulators and banks are domestically oriented and have very limited access to international networks. In contrast, RPF politicians are internationally oriented and their services-based hub development strategy depends on attracting foreign attention and investment. The state-owned bank (BK) has ambitions of expanding in the region in the future but it is not on the horizon in the next few years. Though pan-African banks have a substantial presence in Rwanda, most invested primarily to increase their footprint in the region. Though BPR Atlas Mara is among Bob Diamond's first investments in Africa, its

[30] Interview, commercial bank, Kigali, June 2017.

investments are primarily focused on securing the Rwandan subsidiary's financial difficulties in the immediate future. In line with the expectations of the project's framework, Rwanda has adopted Basel banking standards but implementation remains confused and difficult. There is reason to doubt the effectiveness of implementation given BNR's capacity and technology constraints. Commercial banks will also be limited by skills, technology, and finance constraints in their aim to meet Basel requirements. Despite this, BNR officials and even some respondents within commercial banks mentioned that they were preparing for 'full implementation and compliance' by January 2018.[31]

The RPF's economic leadership has been the main driving force behind Basel implementation. RPF economic leadership comprises President Paul Kagame, his economic advisors, the Special Policy Unit in the Office of the President, and key ministers who have led The Economic Cluster and have also worked in leadership roles in BNR, including John Rwangombwa, Francois Kanimba, and Claver Gatete. Rwangombwa is the current BNR governor and has served in this post since 2013. Prior to this post, he was minister of finance. Kanimba is a former BNR governor (2002–11) and was the minister of trade and industry until August 2017 when he was replaced in a cabinet reshuffle. Gatete was the minister of finance from 2012 to 2018 and had previously served as BNR governor from 2011 to 2013. Other leading officials (serving at the rank of minister) in The Economic Cluster include James Musoni (the former minister of infrastructure and minister of finance), Francis Gatare, and Clare Akamanzi.

During Kanimba's stint as BNR governor, a decision was taken to adopt Basel standards and though implementation has only been embraced recently, BNR has retained a conservative stance on regulation since Kanimba took over the position in 2002. Successive governors have retained similar conservatism in their regulation of the financial sector. Thus, the economic leadership has taken the decision to adopt Basel standards but BNR is the agency charged with delivering that goal. BNR has some autonomy in the ways in which Basel standards will be implemented but it will be judged by economic leadership in its task of becoming a leading adopter and implementer of Basel standards.

BNR has always been 'quick to follow international best practices', and since these were the standards that were offered to them, the target was to achieve those standards.[32] Beck et al. (2011) cite this as a common experience among African countries where complex rules are adopted to follow international best practice (and out of fear that they would be penalized, e.g. in the form of higher international borrowing costs), even if those rules are not appropriate to the country's needs. A BNR official said, 'after FSAP-2 in 2011, the benchmarks that they would be assessed on were based on Basel II and III so though they didn't tell us to

[31] Interviews, BNR and commercial banks, Kigali, June 2017.

[32] Interview, consultant, Kigali, June 2017.

implement Basel, we would be judged on that basis'.[33] There have been few discussions about the vulnerabilities that may accompany the implementation of Basel banking standards.[34] One IMF official highlighted the uncritical stance that almost all entities operating in the financial sector were taking on Basel implementation: 'As more countries start adopting it, you kind of forget the question of whether it is a good thing or not'.[35]

Though some IMF and World Bank officials claim to have warned the government against implementing Basel banking standards, BNR officials did not remember such warnings.[36] IMF and World Bank officials within Rwanda supported the implementation of Basel banking standards. However, they stressed that discussions of its implementation were 'not high on their agenda'.[37] The IMF, World Bank, and African Development Bank (AfDB) funded training programmes in BNR's bank supervision departments and for risk managers at commercial banks.[38] The IMF has also provided technical assistance for the implementation of Basel banking standards with specific funding for building BNR's supervisory capacities.[39] IFIs have provided access to Basel standards and have influenced the parameters within which banking regulation has occurred. Few alternatives have been provided and the government has not sought other options, thus signalling Rwanda's position as a standard-taker in international financial regulation.

Commercial banks voiced a number of complaints about the implementation of Basel banking standards. However, complaints varied among banks. Though the Rwanda Bankers Association (RBA) exists, banks have not developed a common stance with regard to Basel implementation. Though they acknowledged 'the hurt' that would be experienced in the short term, most said it would be better for the entire sector and their own individual banks in the long term.[40] Most banks complained about the pace at which Basel standards were being adopted. Some bank representatives criticized BNR for 'copy and pasting Basel standards without reflecting on their appropriateness in Rwanda'.[41] Though BNR officials said they were taking a 'flexible' approach to implementing Basel reforms, commercial bankers complained 'there was limited room to manoeuvre' and BNR was 'very punitive'.[42]

Across the sector, there was little resistance to the implementation of Basel reforms. One commercial bank representative said, 'you can't win a fight against your regulator. There's no bank that will do that. Even less in Rwanda'.[43] Larger

[33] Interview, BNR, Kigali, June 2017.

[34] Interviews, BNR, Kigali, June 2017.

[35] Interview, IMF, Kigali, June 2017.

[36] Observations made by former World Bank consultant, June 2017.

[37] Interview, IMF, Kigali, June 2017.

[38] Interviews, IMF and World Bank, Kigali, June 2017.

[39] Interview, IMF and World Bank, Kigali, June 2017.

[40] Interviews, commercial banks, Kigali, June 2017.

[41] Interview, commercial bank, Kigali, June 2017.

[42] Interviews, BNR and commercial banks, Kigali, June 2017.

[43] Interview, commercial bank, Kigali, June 2017.

banks were very critical about the implementation of the capital conservation buffer and the additional requirements that would be in place for SIBs. Most banks, which operated as subsidiaries in Rwanda, were not worried about Basel implementation given that their parent companies had either already enforced Basel implementation across their subsidiaries or were in the process of doing so. Two representatives from regional banks mentioned that they had been forced to be compliant with Basel II and III because their parent company had ordered it.[44] However, they were worried about the pressure that would accompany ensuring there were returns on these new investments. Since the return on investments in Rwanda remained low compared to the region, risk managers in commercial banks said it was 'difficult to see how to get return on investment in the current market when we also have to ask for capital injections from our group headquarters'.[45] Another regional bank representative said, 'If I had to raise capital locally, it would be a struggle. Parent companies may give capital but how do we get returns?' Among commercial banks, there was a consensus that the market was 'highly capitalized without potential for gaining significant returns'.[46]

BK—as a majority state-owned bank and the biggest commercial bank in the country—was in a difficult position. BK officials saw Basel implementation as the right way forward in the long term. However, they were worried about the difficulties and financial burden that would accompany implementation in the short term. Though some representatives from commercial banks argued that the BNR 'may overlook some (of BK's) discrepancies', there is no evidence that such partiality is being practised.[47] While EAC harmonization and the implementation of Basel would help BK expand operations abroad, it was not part of BK's strategy to meet Basel banking standards for that purpose. Instead, the government was more hopeful that large foreign banks could choose to invest in Rwanda because of BNR's decision to enact best practices.[48] In some ways, BK had the most to lose from Basel implementation because they could not avail of a parent company's expertise or funds and largely relied on the domestic market for both skills and resources. After the implementation of Basel, the difficulties BK faced had quickly surfaced. To meet the requirement of maintaining high capital buffers—as part of Basel II and III requirements—BK announced that it would list 222.2 million shares on the Rwandan and Nairobi Stock Exchanges, with the aim of raising $67.3 million (Herbling, 2018). This would dilute the Rwandan government's ownership of the country's largest bank, suggesting that Basel implementation had already begun to limit the developmentalist functions of the state. The RPF government was acting against the short-term interest of its own

[44] Interviews, commercial banks, Kigali, June 2017.
[45] Interview, commercial bank, Kigali, June 2017.
[46] Interview, commercial bank, Kigali, June 2017.
[47] Interview, commercial bank, Kigali, June 2017.
[48] Interview, former BNR official, Kigali, June 2017.

state-owned bank through which most strategic projects are being financed, highlighting the inconsistencies that have characterized the country's development strategy and the government's attitude to the financial sector (Behuria, 2018).

The composition of the private sector also presents significant challenges to domestic banks in their implementation of Basel reforms. Though regulators may be able to direct banks to change the composition of their loan-books, a more significant problem is that very few companies take up large portions of each bank's loan-book. Difficulties with some investments by large institutions (e.g. the RSSB) contributed to the liquidity crunch in the late 2000s.[49] Even today, there are a 'few big institutions taking up 20 per cent of deposits. If one is in trouble, it is difficult to raise liquidity'.[50] The RSSB itself holds about 40–50 per cent of the liquidity in the banking sector.[51] The concentration of the economy among certain institutions thus increases the economy's vulnerability to liquidity crises. Commercial banks also have limited options to diversify their loan-books and this affects the potential of increasing returns-on-equity.

The Rwandan government's stubbornness and ambition to achieve goals is evidenced in its implementation of Basel standards. Yet the desire to achieve goals within the government apparatus has not left much space for receptiveness to feedback before Basel adoption and implementation, signalling the narrow role that BNR has in implementing policy-driven adoption. Indeed, BNR officials and commercial bankers all anticipate difficulties with implementing Basel. A senior BNR regulator admitted that there 'will be complications and some of it, we will figure it out as we go along'.[52] A commercial banker echoed the BNR regulator's observation by saying 'the approach here seems to be: let's go for it and address issues later'.[53] The 'learn as you go' approach to implementing Basel was in evidence in February 2018 when a new Basel III liquidity measurement regime was rolled out for commercial banks, incorporating Basel III's flagship Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). The introduction of NSFR requirements has further exacerbated the already existing problems regarding the lack of availability and affordability of mortgages since banks' balance sheets have to now indicate enhanced maturity matching (Vemuru, 2018). Five other liquidity monitoring tools were also issued for banks including maturity mismatch analysis, cashflow projections, stock of liquidity assets, diversification of funding liabilities, and reliance on parent and other subsidiaries. Ecobank publicly stated that 'this is by far the most comprehensive liquidity measurement regime in our coverage basket' and that 'voluminous haggles between banks and BNR' were expected during the implementation phase as balance sheets would have to be rearranged significantly (Ecobank Research, 2018).

[49] Interview, BNR, Kigali, June 2017.

[50] Interview, commercial bank, Kigali, June 2017.

[51] Interview, commercial bank, Kigali, June 2017.

[52] Interview, BNR, Kigali, June 2017.

[53] Interview, commercial bank, Kigali, June 2017.

It may be surprising that Rwanda—elsewhere classified as a developmental state or in similar ways (Booth and Golooba-Mutebi, 2012)—is embracing global banking standards. This indicates the high degree of international orientation among Rwanda's economic leadership. For the RPF, the pathway to economic security depends on regional integration and a reliance on international legitimacy in the short and medium term. Given Rwanda's geographical vulnerability and lack of resources, the government has an explicitly externally oriented development strategy, with success depending on regional integration. This has been made clear in Rwanda's embrace of Basel standards and amendments made to the 2008 banking law in 2017, ahead of implementation of Basel standards a few months later. The amendments were justified by the need to harmonize Rwanda's financial system in line with regional and international standards. These included small changes including replacing the title of 'Vice Governor' of BNR to 'Deputy Governor' (to harmonize titles with other East African countries) to larger changes like altering the start and end dates of the financial year and strengthening BNR's Monetary Policy and Financial Stability committees (Kwibuka, 2017).

Rwanda's development path is very different from the kind pursued in East Asia. Though BNR does not impose sectoral lending targets, the central government does pinpoint strategic growth sectors. In Rwanda, most loans have been concentrated in real estate, hotels, and other service sectors. One commercial banker said, 'today, if there is a problem in the real estate sector, banks will suffer. Retail banking is very small and our loan-books are concentrated'.[54] For example, construction and hotels accounted for 45 per cent of BK's loan-book in 2016, with another 40 per cent being allocated for commerce and transport loans. According to one banker, 'this was done strategically and it is a ticking time bomb. In most other countries, the regulator would have seen this as concentration and stopped it'.[55] For a small country like Rwanda, the pursuit of economic development is accompanied by a great deal of instability. That instability is often generated through external pressures but resources are also received from international sources. Thus, the high degree of internationalization has combined with some facets of a developmental state to create a conflicted development strategy, which combines aspects of market-led reforms and strategic state interventions (Behuria, 2018).

## Conclusion

The policy-driven pathway to convergence with Basel standards in Rwanda provides interesting contributions to our understanding of why developing countries

[54] Interview, commercial bank, Kigali, June 2017.
[55] Interview, commercial bank, Kigali, June 2017.

implement Basel standards. First, it highlights how two aspiring 'developmental states' (Ethiopia and Rwanda) have developed such strikingly different attitudes to Basel adoption and implementation. While Ethiopia and even Bolivia have highlighted clear distinctions between developmental state objectives and Basel adoption objectives, the RPF government has failed to distinguish between such objectives (and the contradictions between them). Another interpretation could be that the RPF government feels that its services-based development strategy requires the adoption of 'best practice' financial standards. Yet the announcement that the government will reduce its shareholding in BK through a public offering on the Kigali and Nairobi stock exchanges highlights how the government's developmentalist ambitions may be at risk. Thus, the implementation of Basel standards has brought into focus the inconsistencies within Rwanda's development project where the government 'want to be all things to everyone'.[56]

Unlike other policy-driven examples, though, the RPF government has demonstrated consistent conservative regulation practices in the banking sector. There is less political contestation compared to Ghana and the rapid adoption of Basel standards has not been opposed. Yet there are severe deficiencies in technical capacity and expertise in the sector and Basel implementation seems largely out of touch with the realities of Rwanda's shallow and underdeveloped financial sector.

There is still a lack of clarity within the banking sector about aspects of the implementation process. The government and commercial banks, in their 2018 annual statements, claim that IFRS 9 has been implemented but in 2017, most commercial banks argued that there was no way this would be possible. The consequences of Basel implementation have already led to a restructuring of the commercial banking sector, with BK's ownership and role in the country set to change. BK will face challenges to Basel implementation given its status as the largest Rwandan bank in a sector where subsidiaries have better-funded and more-skilled parent companies. Atlas Mara BPR already faces significant challenges—particularly in relation to non-performing loans—and will encounter additional difficulties. Other banks may find it much more difficult to receive returns on their new investments in Rwanda where non-performing loans are the highest in the region and return on equity is the lowest.

Basel implementation will undoubtedly bring significant change to Rwanda's financial sector. Yet there is no guarantee that it will help the RPF government achieve its goal of becoming a financial sector hub. Unless feedback mechanisms are integrated within the implementation process, it is likely to result in negative consequences in the short term for banks. Thus, the case of Basel adoption in Rwanda provides us with an interesting snapshot of a small developing country, which is committed to pursuing economic development, trusting the standards of international financial institutions with limited critical engagement. In Rwanda's

[56] Interview, consultant, Kigali, June 2017.

ambitious development project, there is little room for BNR and commercial banks to voice criticism (in the planning stages) with regards to the scale of the ambition of the country's economic leadership. The consequences will be borne out in the coming years as banks and the regulator grapple with Basel implementation.

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