RESEARCH REPORT SUMMARY

CAUSES OF NON-PERFORMING LOANS IN RWANDA MICROFINANCE SECTOR

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ACCESS TO FINANCE RWANDA

AMIR

For Quality and sustainability Microfinance services

Foreword

Microfinance sector in Rwanda aims to provide financial services to the poor; low-income unbankable clients and those with no sufficient collaterals for access to banking services.

Formal credit and savings microfinance institutions for the poor have been around for decades now, providing customers who were traditionally neglected by commercial banks. They forged a way for the unbankable to obtain services that include, but not limited, to savings, credit, transfers, insurance, etc.

On the task to boost the poor's access to financial services, Microfinance institutions face challenge if not a vulnerability: Non-Performing Loans. Since most microloans are not easy to secured, non-performing loans can quickly spread from a handful of microloans to a significant portion of the institutions loan portfolio. I.e. microfinance institution (MFI) not receiving its money back from borrowers (plus interest) has increasingly become a concern for microfinance institutions in Rwanda.

In 2014, AMIR with support from TROCAIRE and Access to Finance Rwanda has commissioned for a key document of advocacy and communication strategy in the microfinance sector in Rwanda to research on the issue.

The present document summarizes the findings of the research conducted about causes of Non-Performing loans in the microfinance sector of Rwanda. The research was conducted through documentary review, interviews, discussions and field consultations with AMIR staff, microfinance institutions, their clients and other relevant stakeholders.

The present document also recaps briefly the report on the critical analysis of information collected; which details identified causes of Non-Performing Loans; and proposed solutions to AMIR and microfinance sector stakeholders. The ultimate goal is about stimulating all discussions, decisions and/ or actions to be taken by competent stakeholders for the sake of finding solutions for the 14 identified main issues.

Peter RWEMA

Executive Director

Background & Problem statement

Microfinance sector in Rwanda is young. The first microfinance existed in 1975 with the establishment of the First Banque Populaire at NKAMBA (former KABARONDO commune). After the 1994 Genocide in Rwanda, the microfinance sector has known a tremendous progress through the support of relevant international and non-government organizations especially for humanitarians. The NGOs helped the population with support of daily equipment and foods but had a microcredit teaching program too. During the emergency period, in some cases loans did not differ from grants or donations which sowed confusion among the population. Thus the culture of not paying normal bank loans rose up causing non-performing loans up to the rate of around 45%.

The average ratio of Non-Performing Loans (NPLs) to total gross loans in the EAC region was 7.8% at end of June 2014, Burundi and Tanzania recorded the highest NPL ratio in the EAC region with 12.7% and 8.2%. In Rwanda, Non-Performing Loans for banks was 6.6% by end June 2014. For microfinance, the NPL ratio was 7.6%3.

About AMIR

The Association of Micro-finance Institutions in Rwanda, AMIR was created in June 2007. It is an umbrella body for microfinance institutions in Rwanda. It seeks to build a flourishing microfinance sector in Rwanda through different areas of Advocacy and Information, research and development, responsible finance, performance monitoring and capacity building. Currently, AMIR has active members.

Vision

To become a strong and efficient organization that contributes to the development of the microfinance industry through the promotion of transparent management systems in MFIs, innovative and market led financial services and products.

Mission

The mission of AMIR is to offer diversified services to microfinance institutions to enable them to work professionally and contribute to poverty reduction in a sustainable manner.

Services

- *Research, performance and Monitoring*
- *Capacity building and SACCO promotion*
- *Advocacy information collection and dissemination*
- *Responsible and inclusive finance*

Microfinance Sector Facts

At the International level

- In 2014 the Microfinance market outlook counted more than 10,000 microfinance institutions (MFIs) limited companies serving more than 100 million clients and attracting billions in investment.
- Only around 500 of these MFIs are suitable for investment, i.e. they are self-sustaining in economic terms and have appropriate governance, business processes and accounting standards in place.
- Approximately 100 MFIs are institutions that operate profitably.
- 400 are smaller and younger MFIs that are profitable or are approaching profitability and are often preparing to undergo a legal transformation to become a more formal type of institution.
- Approximately 9,500 Microfinance institutions are subjected to low growth due to various factors such as poor management, poor governance, lack of proper strategic management,

inadequate macroeconomic policy, lack of economic and political stability and high Non-Performing Loans

In the East African Countries

- In Kenya, eight credit-only MFIs have been transformed into deposit-taking MFIs supervised by the Central Bank of Kenya. They have separate licensing and transparency requirements, deposit protection, dissolution mechanisms, corporate governance, and accounting standards.
- In Uganda there are five deposit-taking MFIs and a few smaller MFIs. Only two banks and the deposit-taking MFIs are found out of Kampala. The microfinance sector is regulated by the Bank of Uganda.
- Tanzania has less than a dozen major MFIs. The MFIs reach a relatively small number of 300,000 active borrowers and 390,000 savers. The leading MFI, with 100,000 active borrowers, is Arusha-based Pride.

Microfinance sector facts in Rwanda

- Rwanda financial stability report 2013-2014 and statistics from National Bank of Rwanda (BNR), record 493 players including 13 limited microfinance institutions, 64 SACCOs and 416 Umurenge SACCOs by the end of June 2014
- The sector recorded an increase of assets size of 20.8% between June 2013 and June 2014, rising from FRW 122 billion to FRW 147.4 billion.
- The total assets were RWF 128.7 billion in December 2013 and RWF 159.3 billion in December 2014.

The Research

Objective of the research

The objective of this research was to understand the causes of Non-Performing loans and to find solutions that reflect views and opinions of MFIs and other relevant stakeholders in relation to various issues affecting microfinance industry and write position papers on the identified issues which may be presented to concerned authorities for action.

Methods & Participants

The research focused on collecting information on the causes of Non-Performing loans in Rwanda microfinance sector through documentary review, interviews, discussions and field consultations with AMIR Executive Secretariat and staff, microfinance institutions, their clients and other relevant stakeholders.

The research used both quantitative and qualitative approaches. Random sampling was used to select 96 MFIs from all Provinces and Kigali City. In total, 350 persons participated in this research; 74 Managers and 104 Loan Officers and members of Credit Committees were interviewed besides 172 clients from microfinance were also interviewed.

Causes of non-performing loans in Rwanda

Causes related to policy and legal framework

1. Securities registration

Most MFIs rely only on the existence the law no 10/2009 of 14/05/2009 on mortgage registration and selling in case of failure to pay back loans without registering borrower's collateral because they find securities registration to RDB expensive.

The risk associated with such unregistered collateral is that the MFI finds it difficult to recover such loan through legal means because it will find itself in a weak legal position. Finally, MFIs end up avoiding the procedures hence getting unpaid loans in the long run.

2. Judicial processes

The judicial process provides that MFIs submit defaulters before the commercial courts. Legal Action, Outsourcing (External solicitor/ Debt collectors) and write off are the most procedures used to manage defaulters' cases. However, they reported that commercial courts are far from most MFIs as there are only 4 courts in the country (Nyarugenge, Huye, and Musanze and High Commercial Court in Kigali). The access to judicial process is itself of a deposit of Rwf500000 per individual case is byfar expensive compared to the defaulted amount of the microloan.

Causes related to supervision

The supervision is conducted by both the National Bank of Rwanda and Rwanda Cooperative Agency. Due to the large number of MFIs to be supervised (13 limited microfinance institutions, 64 SACCOs and 416 Umurenge SACCOs); there is a lack of frequent supervision.

Causes related to Hanga Umurimo Programme (HUP)

Business Development Fund (BDF), as a core partner in HUP, provides 75% guarantee funds for the approved HUP projects and financed by Commercial Banks and Microfinance institutions including SACCOs. However, the programme is facing many challenges including the lack of collaterals, diversion of loans, misunderstanding of HUP and BDF guarantee taken by MFIs and SACCOs (clients thinking of it as a grant or free money from Government) , delays in payment by BDF, etc.

Causes related to inadequate sharing of information among financial institutions through the Credit Reference Bureau

To effectively lock out serial defaulters, MFIs need referencing solution that enable them submit and share data whilst processing their customers' credit application.

Causes related to Microfinance institutions themselves

- Lack of qualified and experienced financial services professionals
- Lack of proper appraisal of loan applications
- Lack of financial education for clients
- High interest rates
- Ineffective monitoring and weak recovery systems
- Inadequate financial analysis

Causes related to lending activities

The most affected are clients involved in the agricultural sector as for delayed reception of loans for instance compared to planting season dates.

Causes of non-performing loans related to lending to solidarity groups for health insurance (ibimina bya mutuelle de sante)

When "Mutuelles de Santé" is funded through lending from MFIs and SACCOs, farmers are grouped in organizations known as tontines or Ibimina. It was found that loans given to the solidarity groups constituted generally under pressure from Local Authorities are not paid.

Non-compliance with credit policy

- Customer pressure (39%)
- Management PRESSURE IN order to meet performance CONTRACTS IN specific national programs (11%)
- Ignorance of the REQUIREMENTS (26%)

Delayed loan approval (60.5%)

Delays in approving loans cause the loss of business opportunities. Hence borrowers tend to misuse the funds or at best use them for wrong or unplanned and hazardous business ventures. Consequently, they are unable to repay the loan in the end.

Causes related to Clients

- Business failure
- Diversion of funds
- Lack of credit culture
- Inadequate skills
- Wilful default

Solutions and recommendations related to control the causes of NPLs in Rwanda microfinance sector

Vis-à-vis policy and legal framework

- Decentralization of registration of collaterals by RDB to districts and sectors;
- Registration fees for collateral should not be flat rather proportional to loan size;
- AMIR should avail a loan contract template with all required clauses to protect MFIs and SACCOs;
- The mortgage law should be revised to allow small loans below 1 million to be registered at sector level.

Vis-à-vis costly and long judicial processes

- The Commercial Court services should be brought to District level and Court fees should be fixed according to the loan size
- Many MFI and SACCO defaulters should be grouped into one case to be submitted to court;
- Cases of MFI and SACCO loans below 3 million should be handled by Abunzi and Public bailiffs should be given power to handle MFIs and SACCOs cases;
- There should be refresher courses for judicial practitioners so to allow them understand how microfinance institutions work;

- Recently fees introduced by the Association of lawyers should be a reasonable charge fees especially for MFIs and SACCOs whose loans minimal amounts
- Advertisement of auctioning of collaterals should be on notice board and in the public offices rather than in newspapers.

Vis-à-vis supervision

- The Central Bank should supervise frequently the SACCOs including delegating some of its roles to another organization of their choice;
- There should be a clear separation of the supervision role by BNR and RCA;
- Standard templates should be established and used by regulators for supervision.

Vis-à-vis NPLs guaranteed by BDF in Hanga Umurimo Programme

- MFIs and SACCOs should transmit to BDF all proof documents to be refunded the 75% guarantee;
- There should be sensitization on proper use of funds from HUP and the role of BDF Guarantee

Vis-à-vis inadequate sharing of information among financial institutions through the Credit Reference Bureau

- All MFIs and SACCOs should send information to CRB to comply to BNR requirements;
- MFIs and SACCOs should log in to CRB to check the credit history of loan applicants

Vis-à-vis lack of qualified financial services professionals and proper loan appraisal

- Qualified personnel for key positions such as Branch Managers, Loan supervisors and Loan officers should be hired;
- Staff training mainly operations should become part and parcel of the institution's life.
- Audit Committees, Internal auditors, Branch Managers and Loan supervisors should ensure that loan officers and members of Credit Committees comply with policies and procedures
- MFIs and SACCOs should always develop repayment schedules that are stress free and easy for clients to repay and mostly according to the cash flow of the clients.

Vis-à-vis financial education in clients

- MFIs and SACCOs should seriously be engaged into conducting financial education to their clients before they get a loan.
- MFIs and SACCOs should develop simple business plan templates to prepare business plan for the clients
- There should be appropriate financial education curriculum to MFIs and SACCOs (AMIR and RICEM) and in formal education (REB, AMIR and RICEM)
- MFIs and SACCOs clients need to go through business development (BDS) training conducted by various centres

Vis-à-vis ineffective recovery systems, agriculture sector and Ibimina bya Mutuelle de Santé

- Close follow up on daily basis, frequent visit and advice to the client for the good management of the loan and also check to ensure the client has experience with the business before giving loan;
- Put the reminder system so as to remind the client for like 4 times using SMS on the due date of repayment 2 weeks before the repayment time;
- Announce the defaulters in the cell meetings during Umuganda sessions
- There is a high need to introduce micro insurance products that covers unforeseen circumstances such as poor weather, crop and animal diseases.
- Collaboration between Local Authorities and SACCOs to better organize Health Insurance solidarity groups and set up an appropriate recovery strategy.

CONCLUSION

Microfinance institutions in Rwanda experience high levels of non-performing loans. This trend threatens viability and sustainability of MFIs and hinders the achievement of their goals. MFIs are very important in not only banking the low income earners in the society, but also in advancing credit facilities to them.

This research deduced that causes of NPLs include among others: inappropriate policy and legal framework; lack of supervision; inadequate sharing of information among MFIs through the Credit Reference Bureau; weak management of loans by MFIs and lack of financial skills for the clients.

Solutions and recommendations formulated for MFIs and SACCOs include among others: seeking qualified and experienced financial services professionals, providing financial education for clients, improving the appraisal of loan applications, the financial analysis and the monitoring and recovery systems.

The Credit Reference Bureau collects information on borrowers from lending institutions which they compile into reports that are used by the lenders to assess creditworthiness of individuals or companies.

The Credit Reference Bureau collates the information of all borrowing customers into a common database where the credit history of any loan applicant can be cross-checked for a sound credit decision.

MFIs must pass information to CRB on a monthly basis. However, some MFIs do not share information on time with the Credit Reference Bureau on loans granted. Also, small MFIs find the cost of accessing to CRB database high which is a flat cost (50 $US per month) and complain on the no availability of network to access that database.

It is therefore recommended to the management of MFIs to avail themselves of the services of CRB to enable them to check the credit history of loan applicants. This reduces the incidence of loans going bad since the MFIs will avoid lending to borrowers with unsatisfactory credit record.

Mission

The mission of AMIR is to offer diversified services to microfinance institutions and the sector at large to enable them to work professionally and contribute to poverty reduction in a sustainable manner.

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