Changes required in the financing architecture to stimulate Uganda's economic growth

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Uganda Bankers' Association

Promoting Partnerships. Transforming Banking.

Content

1. Financial Sector Eco-System.
2. Cross cutting challenges in the eco-system.
3. Challenges/Limitations/Constraints specific to the banking sector.
4. Recommendations to enable financial sector stimulate growth.

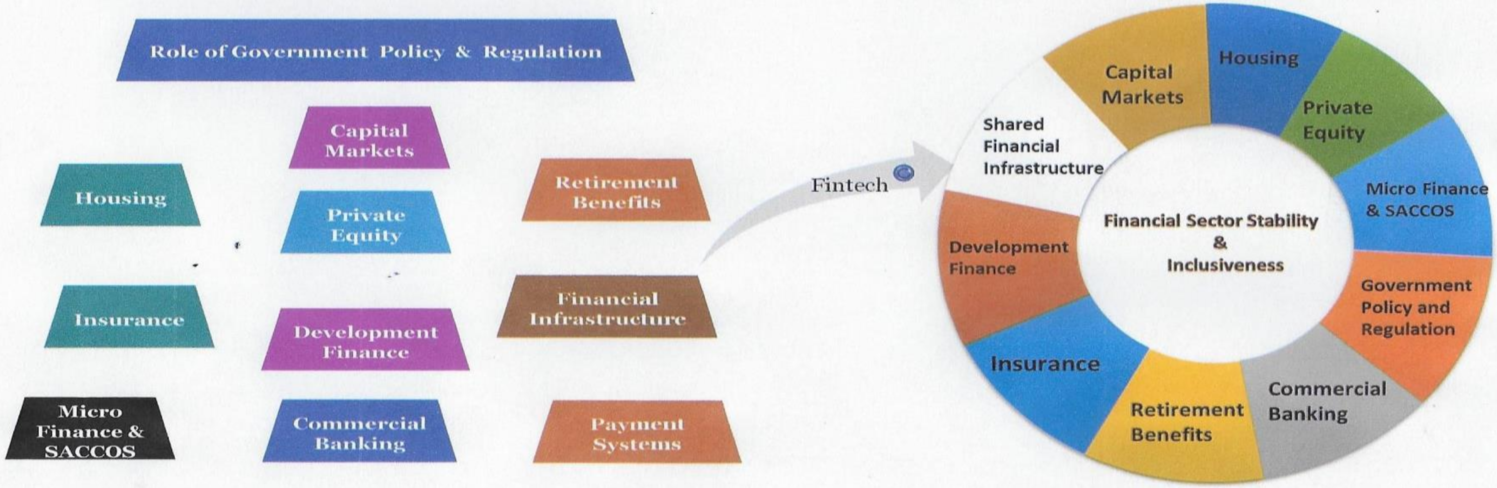
Financial sector eco-system & their different roles

FMDC: Shared Vision

Resolving the structural challenges in the financial markets in Uganda is a central condition for the next stage of our development." This impacts the subject matter of todays discussion.

Disjointed Strategy to Financial Markets Ecosystem Development

Vision of a Coordinated and Holistic Ecosystem



Common OR cross cutting challenges in the financial eco system

1. Shortage of patient capital (long term funding).
2. Cost of doing business. (pricing issues e.g interest rates, yields, returns…).
3. Non performing loans.
4. Reluctance in listing at USE, opening up to other equity partners.
5. Adequacy of policy frameworks.
6. Level of development/sophistication of financial eco system. (limited instruments, market structure, players, regulation ….
7. Economic environment, including GDP size & drivers of GDP growth.
8. Impact of COVID-19: Slow down of economic activity adversely weighinin on all sectors including financial sector with serious implications on loan qulity

Challenges/Limitations/Constraints specific to the banking sector.

Regulatory risk management benchmarks thus must be adhered to by the banking sector/supervised financial institutions

Risk Management Benchmarks

- Sector lending limits to manage credit concentration risks.
- Single obligor limits to manage capital exposure risks.
- Loan syndication frameworks.
- Non performing loan bench marks to minimize capital erosion.
- Loan/Deposit ratios & liquidity benchmarks to manage availability of cash when customers require their funds.
- Provisioning requirements for non performing loans.

Credit Quality Categorisation & Remedial Process Steps

Account Category	Classification	Provision Required/Impact on Share Capital Account	Typical Remedial Action
Standard/Normal Accounts	Uptodate with loan repayments, under 30 days	No provision	Encouraged, usually can secure competitive terms in future.
Watch Accounts	30-89 days		Monitored, check on cause of delay, phone dialogue, written reminders
Substandard Accounts	90-179 days	20%	Issuance of 1st of 2nd or 3rd demand notices, negotiations for restructure if necessary, options being put on the table.
Doubtful Accounts	180-364 days	50%	External recovery measures commence including legal means e.g lawyers, recovery agencies, notices of foreclosure. Restructures still an option.
Loss Accounts	365 days	100%	Notice of foreclosure 1st 30 days, 2nd 15 days, 30 days advert to sell/auction etc , even then customer given option to look for buyer. Revaluation undertaken. *** Prudential guidelines allow restructure only twice!
Written Off Accounts	Above 455 days		Foreclosure, while other Recovery efforts continue

Credit relief measures post lock down

July 2020 Restructures	%	Vol	Value
No of applications rcd		17,589	651.4 billion
No of applications processed	95.3%	16,762	497.4 billion

June 2020 Restructures	%	Vol	Value
No of applications rcd		97,624	1.45 trillion
No of applications processed	98.3%	95,983	1.16 trillion

May 2020 Restructures	%	Vol	Value
No of applications rcd		593,539	3.4 trillion
No of applications processed	99.1%	588,474	2.5 trillion

April 2020 Restructures	%	Vol	Value
No of applications rcd		758,785	2.79 trillion
No of applications processed	99.6%	755,650	2.03 trillion

Non Perform Loans

- NPLs increased by Ugx 123 bn in the Qtr ended June 2020 bringing total NPL to 5.8%(Ugx 894bn).
- There is likelihood of further deterioration because the maturing relief (restructures (1-3 mts, 3-6mts, 6-9mts, 9-12 mts). (*50% in real state & trade).*
- Outlook & stress tests indicate if NPLs rise to 7.2% (Ugx 1.12trn) by end of Sept, or 9.1% (Ugx1.33 trn) by end of Dec 2020.
- NPL in Kenya is (13%) with total loan book of Ugx equivalent of 99 trn vs Uganda loan book of 16trn.
- Banks are increasing investment in treasury bills (now 38.2%) as risk measure against expanding credit in tough/uncertain times. (nearly 40% of PSC)

Proposals/Recommendations
to enable
Financial Sector
stimulate Uganda's economic growth

Role of Capital Markets (CMs):

- Numerous synergies exist and CMs compliment banks as major players in the financial markets
- CMs expand financing capabilities (*Credit & liquidity*) of the market by way of long term/patient capital to both financial institutions & end user borrowers.
- CMs thus help in diversification of sources of finance (Debt, Equity, Mezzanine, Gtees,) and help in addressing funding mismatches & risk sharing.
- In a well functioning market, the above two automatically bring down interest rates (loan pricing) especially if there is adequate supply (funding) in appropriate currency.

How Capital Markets Thrive:

- Operating environment must be attractive to big & small players. Uganda must be an attractive investment destination. (Yields, Tax Policies)
- Consistency & certainty in **policy direction**, monetary & fiscal policies (WHT on instruments>10 years taxed at 10% yet in Kenya & Tz it is at 0%), other stimulus to make it attractive for private capital to flow e.g (ease of dispute resolution)
- Good legal, regulatory oversight framework including robust dispute resolution framework.
- Availability of good or large attractive deals, transactions…… & sustainability therein. (returns, yields).
- Increase in products (stocks, Bonds, commercial paper, preference shares, medium term notes)
- Willingness of businesses to open up (give up/sell portion of stake….ownership) (Most Ugandan businesses are family owned not willing to give up stake.

Recommendations: UMRC

Urgently establish the Uganda Mortgage Refinance Company (URMC).

- This is a secondary market framework that offers financial institutions like banks medium to long term re-finance & liquidity in the mortgage market. The URMC can buy off housing mortgage loan books from banks after <5 years and run the mortgage for longer tenures. This releases & makes available more funds for mortgages as well as bring down the cost of mortgages hence increasing the number of qualifying borrowers.

- The feasibility study by the world bank is complete, process to set in motion its establishment must now begin as priority!

- **Capitalization Strategy:**

Category A: Govt, Tier I Banks, Pension funds, Insurance, UFA.

Category B: Institutional lenders like IFC, Private Equity.

Target amts like UGX 4trn in first years up to 10-15trn in next-10 yrs.

Recommendations: Uganda Devt Bank/ ACF

- UDB mandate better placed for larger projects that have multiplier effects than SME Market.
- Loan book of 334bn too small for development bank meant to drive stimulate growth.
- ACF Fund size too small!
- **Fast track national policy on DFIs.**
- Reduce Government stake in UDB/ Increase provision for stake of other DFIs/International agencies or capital raise via international development agencies in international capital markets..
- Channel specific long term borrowing & provide government guarantees to route money to UDB: Target at least 15 trillion. (Scale).
- Put in place strong legal frameworks, supervisory arms, independent evaluations & sound financial & risk management frameworks.

Recommendations: Banking Sector

Banking Industry review/reforms by Central Bank of Uganda focusing on the following,

- Review/consider the effectiveness of CBR as a monetary policy transmission tool for interest rates vs inflation management/targeting.
- **Consider value of collateral when computing provisions.**
- Focus on strategies aimed at enhancing effective competition based on specific prudential or market requirements including review of minimum prudential capital requirements.
- Focus on & support strategies aimed at supporting/facilitating/driving both individual internal & industry driven efficiency initiatives like shared digital platforms, shared infrastructure etc that cut across & benefits all through economies of scale that can be passed on end user consumers.

Risk of false alarms:

Call for cation about financial sector reporting.

- Un-balanced reporting either without getting the views of the other party or mis-representing facts or outright falsehoods out of lack of subject knowledge.
- Defaulting borrower give one sided negative stories to create impression bank is under stress which could trigger bank runs...
- Closure of a branch due to COVID, then circulation of fake news that all branches have closed.

Thank you