Scaling-up Regional Financial Integration in the East African Community

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Executive Summary

Objectives of the Report

This report follows up on a 2007 World Bank study, *Financial Sector Integration in Two Regions of Sub-Saharan Africa: How Creating Scale in Financial Markets Can Support Growth and Development* (FSITR henceforth) which identified the opportunities associated with regionalization of financial markets in sub-Saharan Africa (SSA), and also the many challenges associated with realizing the potential of such arrangements. This effort furthers and updates the analysis of the EAC in FSITR by focusing on two aspects of trade in financial services within the EAC:

- Documenting a clearer picture of financial integration in the EAC, as it is actually taking shape on the ground; and,

- Elaborating on the challenges specific to the integration of Burundi and Rwanda who joined the EAC subsequent to the preparation of FSITR.

The recommendations are intended to provide inputs which will assist identification of projects to be financed under the proposed EAC Regional Financial Markets Integration Project.

Background

A strong theoretical case for the pooling of small, fragmented financial markets in SSA in order to realize “systemic scale economies” already exists. FSITR provides, *inter alia*, a theoretical foundation establishing the importance of achieving scale in financial services in order to promote financial sector development in Africa, and in particular to lower the cost of financial services, increase competition and innovation, and increase access.

However, the actual experience with regional financial markets (RFMs) in SSA has frequently been less encouraging. Simultaneous multiple, overlapping, memberships in a number of regional economic communities (RECs) have proven to be an obstacle to effective partnerships in any one REC, and this constraint has been reinforced by limited intra-regional trade, uneven political commitment to integration, and limited regulatory and supervisory capacities.

Moreover, the theoretical arguments in favor of RFMs are usually built in the context of a group of small but equally developed financial systems, all of whom stand to benefit equally from the formation of a RFM. However, when financial markets in one partner country (South Africa in the SADC, Nigeria in ECOWAS and WAMZ, and Kenya in the EAC) are significantly more advanced, the fear of domination by foreign financial institutions frequently undermines the commitment to regional integration in other partners. In the case of an unequal partnership
there are also very real questions about the ability of regulators to monitor cross-border financial sector risks and inoculate against contagion.

**Financial Integration in the EAC**

(i)  **Commercial Banks, Insurance Companies, and Capital Markets**

In East Africa banks have generally been ahead of the formal integration process in taking advantage of the potential of the regional market. Several banks have to some degree adopted a regional business model motivated by a range of factors including client-demand, their own corporate structures, and/or by opportunities perceived along the regional trade corridors. These banks display a fair degree of operational integration not just within EAC markets but all the way along the trade corridors to southern Sudan and the eastern Democratic Republic of Congo (DRC).

Kenya-based banks are leading regional integration in the EAC banking sector. About 11 multinational and Kenyan owned banks use Kenya as a hub for their operations in the EAC region. There are four indigenous Kenyan banks with branches within the region. These banks include KCB, Equity Bank, Fina Bank, and Commercial Bank of Africa. These banks have a total of 63 branches outside Kenya (16 in Tanzania, 31 in Uganda and 16 in Rwanda), whereas banks domiciled in other EAC countries operate exclusively in their home markets:

There are no Tanzanian or Ugandan insurance companies with a regional presence. However, there are indigenous Kenyan insurance companies with branches within the region. These include: APA Insurance, Insurance Company of East Africa, (ICEA), Jubilee Insurance, Phoenix of East Africa, Real Insurance, and UAP Insurance. The estimated number of Kenyan insurance company branches within the region is about 30.

Several Kenyan stock broking firms have subsidiaries within the EAC region. These include, Dyer and Blair Investment Bank (Uganda and Rwanda), Faida Securities (Rwanda), and Kingdom Securities (Rwanda). Each of these stockbrokers has only one branch in the regional countries they operate in.

The integration of the EAC stock exchanges is planned to take place in 2012. The first move to integrate the exchanges was to develop common automated trading and clearing platforms. This adoption is currently underway, with Uganda adopting the same automated trading system (ATS) that is used by Kenya, and Tanzania and Rwanda expected to follow suit (Burundi does not yet have a stock exchange).

Prior to implementation of a common trading platform, cross-listing of shares in the EAC is already occurring and has increased private capital flows within the region. The total market capitalization for cross listed shares in the EAC region stands at about US$2.88 billion with
99.84 percent being taken up by the NSE whilst 0.16 percent is shared between DSE and USE. All companies cross-listed and traded regionally are headquartered in Kenya, and to date there have been no cross-listings of companies based in other EAC countries.

Participation in EAC stock and bond markets is usually dominated by institutional investors, national pension funds, fund management firms and insurance companies. Information provided by Kenyan investment banks estimates the participation of Kenyan investors in other EAC markets at about 10 percent of market turnover, whereas that of Ugandan investors in other EAC markets is between two and five percent, and of Tanzanian a maximum of 0.5 percent. Due to the lack of restrictions on capital flows from Kenya, a greater number of its retail investors participate in other EAC markets, and this contrasts to Tanzania and Uganda where mainly institutional investors participate.

(ii) Operational Integration of Commercial Banks

The growing presence of cross-border banks in the region raises the question about the inter-connectedness of EAC financial markets based on the extent of operational integration of bank subsidiaries: to what extent are banks already pooling resources/functions across subsidiaries and effectively operating as a single regional entity although EAC rules do not yet allow single licensing or cross-border branching? To answer this and other questions we surveyed a number of banks with operations in more than one market in the EAC.

Among the banks interviewed more than half have their operations in the East African region with hubs mostly in Kenya. Most of the banks surveyed have yet to achieve full integration of their operations in the region, but partial integration has taken place in the areas of ICT, risk management, customer service, and treasury operations. A few banks have not significantly integrated their regional operations, with most of their operations carried out at the individual country level.

For the purposes of this report it is especially significant that two-thirds of the banks state that regionalization has facilitated the introduction of financial products and services that would not have been possible in the absence of scale. This supports the argument made in FSITR that scale is important to increasing breadth and depth of financial access.

Establishment of a single licensing regime (which would remove barriers to entry posed by separate capitalization requirements for each subsidiary and enable cross-border branching) is favored by a majority of the banks as a measure which would promote integration.

The major impediments to attaining full integration cited by banks are: the lack of a common tax regime; resistance from bank supervisors (particularly in Tanzania and Uganda, who are averse to banks under their jurisdiction being managed by Kenyan parents); IT connectivity problems (caused by weak physical infrastructure); regulatory requirements;
restrictions on the mobility of labor; and, the existence of differing capital movement polices within the EAC.

Only Tanzanian banks reported that they have had their operations supervised by a central bank in another country in the region in addition to supervision by the host country’s central bank. Moreover, the additional supervision only consisted of routine inspections.

(iii) Going forward

Several factors still constrain the growth and integration of the regional market. At the same time there is reason to stay alert to the risks that come with increasing cross-border financial links. Thus, the path forward should involve taking steps that on the one hand facilitate the movement of funds between EAC members, and on the other ensure a more careful tracking of the volumes and consequences of these flows.

- **Harmonization of legal and regulatory frameworks:** The banks surveyed cited differential tax regimes and other regulatory discrepancies as a major hindrance to further integration. Further work needs to be done to align regulatory and supervisory frameworks and reporting requirements to address this issue.
- **Mutual recognition among regulators:** Adopting single-licensing will have to be accompanied by mutual recognition among regulators and this will require that national regulators converge around some broadly defined international principles such as the Basle core principles for bank supervision, IOSCO, and others.
- **Adopting a single licensing regime.** Banks surveyed during in the preparation of this report cite single licensing as an important aid to further integration. If introduced for banks, single licensing should also be extended to other market participants such as brokers and insurance companies in order to significantly reduce cross-border transaction times and costs and barriers to entry.
- **Building-up regionally compatible financial infrastructure.** Kenya, Tanzania and Uganda have already made substantial progress in integrating their RTGS. Rwanda and Burundi also need to align their payments systems with the regional system. Similarly, it is necessary to ensure that other parts of national financial infrastructure, including CSDs and trading platforms for national exchanges, are compatible at the regional level.
- **Strengthening cross-border supervision:** Deepening links between financial institutions warrant a similar deepening of cooperation between supervisors. As indicated by surveyed banks instances of scrutiny by supervisors in other countries are rare. Home-host supervisory communication and regionally-consolidated supervision are both important to ensuring that weaknesses in one financial institution/market do not put the regional financial system at risk.
- **Strengthening data gathering.** Information on current volumes of cross-border trade in financial products is generally sketchy and incomplete. This data gap is problematic, not just
in that policymakers are working with limited information as a basis for making decisions on the issues and opportunities that lie ahead, but also in that it masks the benefits and costs of further integration by obscuring the extent of cross-border linkages.

**Integrating Burundi and Rwanda**

(i) **Overview**

Extending the EAC to include Burundi and Rwanda has greatly added to the diversity of the membership. The three founding members of the EAC have a long history of trade and administrative cooperation (stretching back nearly a century), and as a result of their colonial history have all inherited legal systems based on English common law. Both Rwanda and Burundi are former Belgian colonies, and as a result follow the civil law tradition. It also brings the problems posed by small scale into sharp relief. Of the two countries, the awareness of the need to achieve scale to support high quality regulation and supervision, to support capital markets development, and to build physical infrastructure such as payments and settlement systems, is clearly most advanced in Rwanda. Burundi still lacks a coherent vision of how its financial system will be integrated with the EAC and as a consequence needs to do much work to formulate a strategic vision and move forward with implementing its strategy. The alternative is to see the direction and development of the financial system largely passed to institutions in other EAC countries.

The financial sectors in both Burundi and Rwanda are at a lower level of development than those in other EAC countries. Overall, the financial sector in Rwanda is larger, offers a broader range of financial services and products, and is developing faster than Burundi’s. The degree of cross-border banking sector integration with the rest of the EAC is also higher in Rwanda than in Burundi, with three EAC-headquartered banks operating in Rwanda versus one in Burundi.

(ii) **Burundi**

Interviews conducted with the Burundian financial and business communities conveyed a sense of resignation rather than enthusiasm towards EAC membership. There is acute awareness that Burundi’s low level of development means that the consequence of membership is likely to be a substantial increase in competition from larger and better capitalized firms and financial institutions based in more developed EAC countries – particularly Kenya. Despite this, the view that “Burundi had no choice but to join” prevailed. At an official level, attitudes towards convergence with the EAC were very positive (reflecting in part a strong political commitment at the highest level to the EAC project) but emphasized the major challenges posed by Burundi’s lack of all types of capacity.

In the banking sector, the impact of the EAC was seen chiefly in a rise in trade payments (primarily to Kenya and Rwanda) and increasing levels of transshipment trade related business
Within the sector, there was wide expectation that competition would increase, with Kenya Commercial Bank, Access Bank, Stanbic and Barclays identified as likely to be quick to open Burundi operations, and as a result also recognition that Burundian banks would need more capital to meet competition (a view which was confirmed by the BRB which indicated that it is considering increasing the minimum capital requirement to US$10 million).

Burundi’s financial sector is dominated by a small banking system consisting of seven commercial banks (of which two are majority state owned), two finance houses (both state owned), and a state development bank; and, four very small insurance companies, of which one is majority state-owned. Burundi has the least developed financial sector in the EAC, with total banking system assets of US$288 million (24.8 percent of GDP) and total insurance premiums of US$ 12 million (1.02 percent of GDP) at year-end 2008.

The very modest role of the banking system as a source of finance for the economy is highlighted by a share of loans to GDP of only 6.32 percent. In addition to the banking and insurance sectors, a market for government debt has been created by the BRB, and appears to function well with all banks and insurance companies plus the social security fund investing, but there is no commercial bond issuance or stock exchange. The payments system is outdated, with a clearing system operated by the BRB which is only semi-computerized, slow, and prone to breakdowns.

(iii) Rwanda

In contrast to Burundi, interviews with participants in the Rwandan financial sector showed a much stronger commitment to the EAC. This difference in attitude was, in part, clearly linked to commitment to the Government’s “African Switzerland” development strategy. Within the financial sector, this commitment to the EAC was evidenced by the generally welcoming regulatory attitude towards incoming banks (whether from the EAC or from other parts of Africa) and a strong desire to see a regional capital market come into being. Foreign banks indicated that the licensing process to enter Rwanda had been fairly straightforward, and contrasted this unfavorably with Burundi.

Foreign banks also noted that Rwanda is implementing the EAC’s free movement of labor protocol, and that they have been able to bring in staff from their home countries without any problems (some Burundian financial sector firms also stated they intend to use this right to hire better-skilled staff from elsewhere in the EAC). Somewhat surprisingly - and in marked contrast to Burundian financial sector institutions - Rwandan domestic banks and insurance companies were also positive about the impact of EAC membership on their business, seeing
opportunities to raise additional capital and access a much larger market, including possibly expanding cross-border.

Interviews with Rwandan regulators indicated that there is a strong awareness of the impact of a lack of scale in their home market on their ability to provide quality supervision. They also specifically emphasized the importance of Rwanda pursuing compatible hardware and software solutions for payments and securities trading and settlement systems to allow markets to be more easily integrated. This openness may offer opportunities to promote “win/win” joint solutions which would increase supervisory capacity in both countries, allowing Rwanda to secure the benefits of larger scale while allowing Burundi the opportunity to accelerate reforms by taking advantage of regulatory reforms already advanced in Rwanda (which is starting from a similar civil law framework).

Rwanda’s financial sector is dominated by the banking system which at end-2009 consisted of 9 commercial banks (of which one is majority state owned and all of the remainder have either a majority or a significant percentage of foreign ownership), one housing bank (majority state-owned with full banking license), a state owned development bank (also with a commercial banking license); and, five commercial insurance companies providing property, life and casualty coverage, plus one non-social medical insurance company. In addition to the banking and insurance sectors, a capital market has also been established, with one domestic corporate bond issued in addition to Government bonds, a planned cross-border share listing (Kenya Commercial Bank), and hopes for two or three domestic share listings by the end of 2010.

(iv) Recommendations

- **Develop an EAC Integration Strategy for Burundi’s Financial Sector:** including an assessment of the financing needs of the real sector and the capacity the financial sector to meet these needs; identification of capital shortfalls and financial products needed; assessment of Burundi’s banking and insurance laws and regulations harmonization with other EAC countries.
- **Support to Accelerate Burundi’s Convergence with EAC Financial Sector Laws:** Given the work already done in Rwanda to prepare an EAC convergent laws and regulations for the financial sector, it would make sense – given the common legal heritage of the two countries – for Burundi to use these laws (on banking, payments, collective investment schemes, and capital markets functions) as models for its own reforms.
- **Financing for Supervisory Development:** For both Burundi and Rwanda flexible technical assistance credits could be created to deliver capacity building support on a flexible basis, using a framework contract (in Burundi’s case, this could build on a current FIRST
project). This would allow the regulators in both countries – over a period of three to four years – to draw technical assistance and finance equipment and software on an ad hoc basis.

- **Financing for Burundi’s Payments System:** As discussed above, the Burundi authorities see the logic of purchasing a payments system which is fully compatible with that procured by Rwanda. A substantial cost has already been absorbed by the Rwandan authorities in preparing the specifications for a new system, and financial support could be given to Burundi to “piggyback” on the Rwandan procurement.
1. Introduction

A 2007 World Bank study, Financial Sector Integration in Two Regions of Sub-Saharan Africa: How Creating Scale in Financial Markets Can Support Growth and Development (FSITR henceforth) identified the opportunities associated with regionalization of financial markets in sub-Saharan Africa (SSA), and also the many challenges associated with realizing the potential of such arrangements. The study also assessed efforts to deepen financial integration in two sub-regions, the East African Community (EAC) and the Economic Community of West African States (ECOWAS). This report furthers and updates the analysis of the EAC in FSITR and is intended to contribute actionable inputs for a proposed EAC financial markets integration project. This report focuses on two aspects of trade in financial services within the EAC:

- Documenting a clearer picture of financial integration in the EAC, as it is actually taking shape on the ground; and,

- Elaborating on the challenges specific to the integration of Burundi and Rwanda who joined the EAC subsequent to the preparation of FSITR.

In East Africa banks have generally been ahead of the curve is assessing the potential of the regional market. Several banks have to some degree adopted a regional business model motivated by a range of factors including client-demand, their own corporate structures, or by opportunities perceived along the regional trade corridors. These banks display a fair degree of operational integration not just within EAC markets but all the way along the trade corridors to southern Sudan and the eastern Democratic Republic of Congo (DRC).

Institutional initiatives are perhaps more significant for the development of the non-banking financial sector and capital markets in the EAC. With the exception of motor insurance, insurance products in the region generally have very low penetration rates. Weak regulatory frameworks for the insurance sector and low incomes have hindered the development of markets in all countries, with penetration rates being especially low for life insurance products. Capital markets are also widely disparate in market size, investor base, infrastructure, and regulatory and supervisory capacity. Highly publicized initial public offerings (IPOs) have in the recent past been enthusiastically received by the public and institutions within the EAC, even where the rules on intra-EAC cross-border investment have not been clear. Despite this, cross-listings and cross-border investments are still in their infancy, and several de facto hurdles remain for businesses wishing to raise capital on a regional basis.

Extending the EAC to include Burundi and Rwanda has greatly added to the diversity of the membership. The three founding members of the EAC have a long history of trade and administrative cooperation (stretching back nearly a century), and as a result of their colonial
history have all inherited legal systems based on English common law. Both Rwanda and Burundi are former Belgian colonies\(^1\) and as a result follow the civil law tradition. It also brings the problems posed by small scale into sharp relief. Of the two countries, the awareness of the need to achieve scale to support high quality regulation and supervision, to support capital markets development, and to build physical infrastructure such as payments and settlement systems, is clearly most advanced in Rwanda. Burundi still lacks a coherent vision of how its financial system will be integrated with the EAC and as a consequence needs to do much work to formulate a strategic vision and move forward with implementing its strategy. The alternative is to see the direction and development of the financial system largely passed to institutions in other EAC countries.

The remainder of the report is structured as follows: Section 2 sets the stage by briefly summarizing the case for regional financial markets in sub-Saharan Africa and also the actual experience with regionalization; Section 3 documents the trade in financial services among the three original members of the EAC; Section 4 focuses on the issues specific to the integration of Burundi and Rwanda.

## 2. Financial Market Integration and Development in Africa

A strong theoretical case for the pooling of small, fragmented financial markets in SSA in order to realize “systemic scale economies”\(^2\) already exists. FSITR provides, *inter alia*, a theoretical foundation establishing the importance of achieving scale in financial services in order to promote financial sector development in Africa, and in particular to lower the cost of financial services, increase competition and innovation, and increase access. The advantages that accrue from regional financial markets (RFMs) can be summarized as follows:

- African financial markets are generally too small to generate economies of scale;
- The benefits which accrue from financial sector integration depend to a large degree upon the order in which integrating reforms are introduced;
- Integration leads to increased competition, which in turn leads to lower interest spreads, fees, and other charges;

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\(^1\) Belgium acquired both colonies from Germany at the end of the First World War.

\(^2\) For a detailed exposition of the concept as applied to financial markets please see Bossone, Honohan and Long (2001) and Bossone and Lee (2004).
Increased competition leads to innovation while achieving a critical scale allows operational costs to be reduced sufficiently to permit the introduction of scale-based products aimed at the MSME and retail markets, increasing access;

Increased competition leads to banks “going down market”, increasing access for traditionally under- or unserved segments of the population and getting to scale assumes additional significance when institutions can only realize small profit margins per client; and,

Regionalization allows increased geographic and sectoral diversification, reducing portfolio credit risks and costs, allowing banks to reduce spreads.

However, the actual experience with RFMs in SSA has frequently been less encouraging. Simultaneous multiple, conflicting memberships in a number of regional economic communities (RECs) have proven to be an obstacle to effective partnerships in any one REC, and this factor has been reinforced by limited intra-regional trade, uneven political commitment to integration, and limited regulatory and supervisory capacities.  

Moreover, the theoretical arguments in favor of RFMs are usually built in the context of a group of small but equal-sized countries, all of whom stand to benefit equally from the formation of a RFM. However, when financial markets in one partner country (South Africa in the SADC, Nigeria in ECOWAS and WAMZ, or Kenya in the EAC) are significantly more advanced, the fear of domination by foreign financial institutions frequently undermines nationalist resolve. In the case of an unequal partnership there are also very real questions about the access and ability of regulators to monitor cross-border financial sector risks and inoculate against contagion.

RFI in SSA has usually taken two different, though not mutually exclusive, paths. For some RECs, institutional initiatives including, a common currency, an overarching regulatory authority, and supranational financial markets, are the building blocks of regionalization in financial markets. This applies to West and Central Africa where the two CFA franc zones, regional central banks (BCEAO and BEAC), and a regional stock exchange (the BRVM in the WAEMU) are the cornerstones of regionalization. For other RECs integration is a more market driven process, following the movement of people, businesses and goods across fluid borders. South African and Kenyan banks have led this model of integration in the southern and eastern parts of SSA. Of course, this distinction serves only to highlight the more visible drivers of integration rather than suggesting that market forces are at standstill in the WAEMU and CEMAC regions, or that institutional arrangements are irrelevant in the SADC or EAC regions. WAEMU has a growing regional bond market and the recent signing of the Common Market

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Protocol in the EAC in 2009 is a significant institutional step forward in the regionalization process.

3. Financial Integration in the EAC

A. Background on the East African Community

The EAC was created in its present form in 1999. It is the successor to the EAC formed following the independence of Kenya, Tanzania and Uganda from Britain in 1967, which collapsed acrimoniously ten years later. The “new” EAC started again with the signature in 1999 of a treaty between Kenya, Tanzania and Uganda as members and, in 2007, expanded to include Burundi and Rwanda. The three founding members of the EAC have a long history of trade and administrative cooperation (stretching back nearly a century⁴), and as a result of their colonial history have all inherited legal systems based on English common law. Both Rwanda and Burundi are former Belgian colonies⁵ and as a result follow the civil law tradition.

![Figure 3.1: Population of the EAC](image)

Source: IMF, World Economic Outlook Database, April 2009

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⁴ Kenya and Uganda were both British colonies while Tanzania was a German colony until 1918, when control passed to Britain under a League of Nations mandate as a result of the end of the First World War.

⁵ Belgium acquired both colonies from Germany at the end of the First World War.
The EAC implemented a customs union from the beginning of 2005, and in this context Kenya made a significant concession to the lower level of economic development of Tanzania and Uganda by allowing the union to initially be asymmetric: until 2010 exports from the smaller states are allowed duty free treatment between the smaller states and into Kenya, whereas Kenyan exports to other members are subject to a 10 percent duty\(^6\). The EAC has a common external tariff, but in effect this only applies to countries which are not members of either the Common Market for Eastern and Southern Africa (COMESA) or the Southern African Development Community (SADC) because of cross-memberships between EAC members and those groupings.

Another significant milestone was passed with the signing of the Common Market Protocol in November 2009. The agreement envisages the phased liberalization of trade in financial services and also the elimination of restrictions on the free movement of capital by 2015 at the latest. The required rate of progression is not the same for all members. Kenya, Rwanda, and Uganda who already have substantially liberalized frameworks are also committed to further integration sooner than Burundi and Tanzania. Once the Protocol comes into force, the partner states will progressively in accordance with the Schedule on the Removal of Restriction on the Free Movement of Capital: (i) remove restrictions between them on the movement of capital belonging to the persons resident in the EAC; (ii) remove discrimination based on the nationality or on the place of residence of the persons or on the place where the capital is invested; (iii) remove any existing restrictions on the movement of capital and on the current payments and transfers; (iv) remove restrictions relating to current payments connected with the movement of goods, persons, services or capital.\(^7\)

Already by 2009 the EAC had achieved a degree of legal and institutional strength which gave grounds for optimism about the eventual success of the project: the EAC has its own legislature (which can make laws over-riding national law), judiciary, and secretariat (the EACS). The integration agenda is managed by three top level committees: the Monetary Affairs Committee (MAC) composed of the central bank governors, which has subcommittees covering banking and insurance integration issues in addition to monetary union; the Fiscal Affairs Committee, composed of the Ministers of Finance, which deals with harmonization of taxes and duties; and, the Capital Markets Development Committee, which brings together the securities regulators.

\(^6\) For a snapshot of commodity trade between EAC members see Appendix 1.
\(^7\) For the purpose of the Protocol, capital and related payments and transfers include direct investment, equity portfolio and portfolio investments, bank and credit transactions, payment of interest on loans and amortization, dividends and other income investments, repatriation of proceeds from the sale of assets, and other payments relating to investment flows.
Kenya’s agreement to the asymmetric terms of the customs union described above highlighted its political commitment to the success of the EAC. This commitment derives from a desire to take advantage of the opportunities presented by the EAC to expand markets for Kenyan products, transshipment trade, and expanded investment opportunities for Kenyan companies (which are by and large the largest firms in the region). Kenya’s level of enthusiasm is perhaps shared most by Uganda (which is the main EAC trading partner of Kenya) and Rwanda, which sees integration with the EAC as a means to leverage its strategy of positioning itself as a major transshipment point on the Indian Ocean-Central Africa trade route and developing its economy by offering a transparent and well-governed environment for investment and services.

The political commitment to the EAC of Tanzania and, to a lesser extent, Burundi lags that of the other three members. In Tanzania’s case, there is clearly a fear of Kenyan “takeover” and a split between those in the north of Tanzania whose trade is directed either north into Kenya or East to Rwanda, Burundi and onwards to the eastern DRC, and thus who see EAC membership as advantageous; and, those in the south of Tanzania whose trade is directed towards Malawi, Mozambique, South Africa, Zambia, and Zimbabwe, and who as a result favor Tanzania’s continued membership and strengthening of ties with the Southern African Development Community (SADC). Nevertheless, the benefits of scale are apparent to the average Tanzanian who favor deeper economic ties in the region but are wary of deepening political links.8

In Burundi’s case, official and private sector attitudes towards the EAC are at best lukewarm: there is fear of the takeover of the economy by foreign (chiefly Kenyan) investors, and local businesses described themselves as being adversely impacted by competition from new EAC-based entrants. Despite these factors, support was expressed for EAC membership on the basis that Burundi’s long term interest lies in being part of a larger economic group (“we are too small to survive on our own”), and potential for serving as a transshipment point for EAC trade via Lake Tanganyika with the southeastern DRC, and with northeastern Zambia.

As mapped out in the *EAC Development Strategy 2006-2010* the path forward for the East African Community will culminate in their eventual economic and political unification. While the broad roadmap going forward is fairly well-articulated some of the details closer to the ground are less clear. This report addresses that gap.

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Table 3.1: Macroeconomic Snapshot of the EAC

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<tr>
<th>3.1.ii Share of EAC GDP/Share of EAC Population ( ratio in %)</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Burundi</td>
<td>25.7</td>
<td>26.0</td>
<td>27.4</td>
<td>28.3</td>
<td>25.4</td>
<td>24.2</td>
<td>29.3</td>
</tr>
<tr>
<td>Kenya</td>
<td>145.4</td>
<td>141.1</td>
<td>143.9</td>
<td>155.5</td>
<td>158.2</td>
<td>150.4</td>
<td>143.0</td>
</tr>
<tr>
<td>Rwanda</td>
<td>63.1</td>
<td>64.2</td>
<td>68.0</td>
<td>72.4</td>
<td>73.7</td>
<td>81.5</td>
<td>87.1</td>
</tr>
<tr>
<td>Tanzania</td>
<td>100.9</td>
<td>100.4</td>
<td>96.9</td>
<td>88.4</td>
<td>86.9</td>
<td>91.4</td>
<td>92.9</td>
</tr>
<tr>
<td>Uganda</td>
<td>76.4</td>
<td>82.0</td>
<td>82.1</td>
<td>78.4</td>
<td>78.1</td>
<td>79.5</td>
<td>83.2</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>3.1.iii Real GDP Growth (%)</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009F</th>
<th>2010F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Burundi</td>
<td>-1.2</td>
<td>4.8</td>
<td>0.9</td>
<td>5.1</td>
<td>3.6</td>
<td>4.5</td>
<td>3.2</td>
<td>3.6</td>
</tr>
<tr>
<td>Kenya</td>
<td>2.8</td>
<td>4.6</td>
<td>5.9</td>
<td>6.4</td>
<td>7.1</td>
<td>1.7</td>
<td>2.5</td>
<td>4</td>
</tr>
<tr>
<td>Rwanda</td>
<td>0.3</td>
<td>5.3</td>
<td>7.2</td>
<td>7.3</td>
<td>7.9</td>
<td>11.2</td>
<td>5.3</td>
<td>5.2</td>
</tr>
<tr>
<td>Tanzania</td>
<td>6.9</td>
<td>7.8</td>
<td>7.4</td>
<td>6.7</td>
<td>7.1</td>
<td>7.4</td>
<td>5</td>
<td>5.6</td>
</tr>
<tr>
<td>Uganda</td>
<td>6.5</td>
<td>6.8</td>
<td>6.3</td>
<td>10.8</td>
<td>8.4</td>
<td>9</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>EAC Average</td>
<td>4.6</td>
<td>6.2</td>
<td>6.4</td>
<td>7.5</td>
<td>7.4</td>
<td>5.8</td>
<td>4.5</td>
<td>5.1</td>
</tr>
<tr>
<td>SSA Average</td>
<td>5.1</td>
<td>7.2</td>
<td>6.2</td>
<td>6.4</td>
<td>6.9</td>
<td>5.5</td>
<td>1.1</td>
<td>4.1</td>
</tr>
</tbody>
</table>

*Source: IMF, World Economic Outlook Database, April 2009, World Bank Analysis*

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B. Estimated Cross-Border Investment in the EAC

(i) Introduction

Since financial institutions are not required to report cross-border flows on a bilateral basis it is a challenge to measure the volumes of cross-border financial flows within the EAC. The estimates that follow are based on mainly secondary data and some primary interviews in Kenya, and should be interpreted with appropriate caution. The focus is on financial flows/investment through stock markets, banks, and insurance firms.
Given the relative maturity of its financial sector and economy, as might be expected, Kenya is the favored destination for investors looking for opportunities in the region. In 2008 FDI in Kenya grew 115% with most of the investment coming into the financial services sector. Total investment amounted to US$155 million; Dubai Bank opened four new branches, Bank of India two new branches and the Standard Banking group relocated their global governance and international operations division to Nairobi. There were no investments in the Kenyan financial sector from other EAC countries during 2008.

Traditionally FDI flows to Tanzania have been dominated by the UK, but South Africa and Canada have surpassed the UK in recent years. This can be attributed to increased investment in the mining sector in which these two countries are particularly active, and typically there is not much outside investment in Tanzania’s financial sector. However, Kenya’s contribution to Tanzania’s FDI inflow has been about 3 percent of total flows, averaging US$12.1 million during the period 2000-2005. And this is largely due to the expansion of Kenyan banks, led by KCB, in the Tanzanian market. Uganda does not feature among the top 10 contributors to FDI flows in Tanzania.

Total FDI flows to Uganda for 2007 were US$368 million with Kenya being the highest contributor followed by Finland, China, India and UAE. According to the Uganda Investment Authority (UIA) the manufacturing sector received the bulk of investment, followed by the financial and real estate sectors. In particular, Kenyan banks such as KCB, Equity bank and Fina Bank have been increasing their penetration of the Ugandan market in since 2007.

A more detailed sketch of the cross-border activity via ownership links in various segments of financial markets follows.

(ii) Banking Sector

Kenya-based banks are leading regional integration in the EAC banking sector. About 11 multinational and Kenyan owned banks use Kenya as a hub to expand their operations into the

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11 Tanzania Investment Centre (TIC), 2006, “Tanzania Investment Report”, Tanzania Investment Centre (TIC), Tanzania
13 Tanzania Investment Centre (TIC), 2005, “Benchmarking Tanzania’s Foreign Direct Investment”, Tanzania Investment Centre (TIC), Tanzania
EAC region\textsuperscript{14}. There are four indigenous Kenyan banks with branches within the region. These banks include\textsuperscript{15} KCB, Equity Bank, Fina Bank, and Commercial Bank of Africa. These banks have a total of 63 branches outside Kenya (16 in Tanzania, 31 in Uganda and 16 in Rwanda). Ugandan and Tanzanian banks do not have a regional presence and operate exclusively in their home markets:

- Since 2006 KCB has been expanding extensively in the EAC region. It has 164 branches in Kenya, and 36 branches in other countries in East Africa — Tanzania (10), Uganda (11), Rwanda (9) and Southern Sudan (6). KCB’s Tanzanian operation is the oldest of its regional subsidiaries having been established in 1997;

- In March 2009 Commercial Bank of Africa merged with First American Bank that has a Tanzanian subsidiary United Bank of Africa (the bank has since been renamed Commercial Bank of Africa – Tanzania);

- Fina Bank began its regional expansion into Rwanda in 2004 and has recently entered Uganda in 2009 with five branches already established. The bank now has a total of 11 branches regionally; and,

- In 2009 Equity bank completed the acquisition of Uganda Microfinance in a deal worth US$26.9 million. The microfinance institution had over 45 field offices and branches. Equity Bank Uganda currently operates 15 branches.

Table 3.2: Regionalized Banking Operations in the EAC

<table>
<thead>
<tr>
<th>Bank</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Burundi</td>
</tr>
<tr>
<td>Barclays (UK)</td>
<td></td>
</tr>
<tr>
<td>Bank of Africa (Mali)</td>
<td></td>
</tr>
<tr>
<td>Citigroup (USA)</td>
<td></td>
</tr>
<tr>
<td>Diamond Trust (Kenya)</td>
<td></td>
</tr>
<tr>
<td>Ecobank (Togo)</td>
<td></td>
</tr>
<tr>
<td>Equity (Kenya)</td>
<td></td>
</tr>
<tr>
<td>Fina (Kenya)</td>
<td></td>
</tr>
<tr>
<td>Kenya Commercial (Kenya)</td>
<td></td>
</tr>
<tr>
<td>Standard/Stanbic (South Africa)</td>
<td></td>
</tr>
</tbody>
</table>

Source: Various bank websites

\textsuperscript{14} Maliti, Tom, June 2008, “Banking – Kenya goes Regional”, The Africa Report
\textsuperscript{15} In 2008 I&M bank bought 50% of a Mauritian bank, First City Bank of Mauritius, and intends to open branches in Tanzania and Uganda in the near future.
When estimating intra-EAC investment in the banking sector, we took into account the estimated licensing and capital requirement costs in each country. The licensing and capital requirements costs for Uganda are UGS 4 billion (US$2 million), for Tanzania TZS 200 million (US$11.43 million), and for Rwanda US$2.72 million.

Table 3.3: Cross-Border Investment in the Banking Sector

<table>
<thead>
<tr>
<th>Banks</th>
<th>Country</th>
<th>Est. Investment (US$ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Tanzania</td>
<td>Uganda</td>
</tr>
<tr>
<td>Kenya Commercial Bank</td>
<td>11</td>
<td>2</td>
</tr>
<tr>
<td>Equity Bank</td>
<td>-</td>
<td>26.9</td>
</tr>
<tr>
<td>Fina Bank</td>
<td>-</td>
<td>22.3</td>
</tr>
<tr>
<td>Commercial Bank of Africa</td>
<td>11</td>
<td>-</td>
</tr>
<tr>
<td>Est. Total Investment (US$)</td>
<td>22</td>
<td>30.9</td>
</tr>
</tbody>
</table>

(iii) Insurance Sector

There are no Tanzanian or Ugandan insurance companies with a regional presence. There are indigenous Kenyan insurance companies with branches within the region. These include: APA Insurance, Insurance Company of East Africa, (ICEA), Jubilee Insurance, Phoenix of East Africa, Real Insurance, and UAP Insurance. The estimated number of Kenyan insurance company branches within the region is about 30, with an investment flow of an estimate US$18 million. According to the Tanzania Insurance Supervisory Department and Ugandan Investment

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16 Total estimated licensing and minimum capital requirement per country. Tanzania (US$11), Uganda (US$2), Rwanda (US$2.72).
17 Tanzania banking sector minimum capital requirement Tzs 200 million (US$11 million): Government of Tanzania, “Tanzania Banking Act”
20 KCB also has branches in other East African countries, Rwanda and Southern Sudan. The bank is expected to open a branch in Burundi in 2009
21 KCB Tanzania was established in 1997 and currently has 10 branches; however in 2008 indications were the bank only had 8 branches. For this reason our estimate assumes that the eight branches were established prior to 2006 thus takes into account only two additional branches as part of our investment estimate.
22 The bank bought out Uganda Microfinance in 2009 through a share swap that has about 28 branches and field offices in Uganda. The acquisition was of Ksh 1.66 billion or US$26.9 million.
23 Fina bank currently has 5 branches in Uganda as of February 2009. Fina Bank Rwanda currently has 7 branches.
24 Commercial Bank of Africa initially was started in 1962 in Tanzania and then expanded into Kenya and Uganda. Following nationalization policies in Uganda and Tanzania the bank was forced to close down its other EAC operation, leaving only the Kenyan Bank.
Authority (UIA), minimum capital requirements for insurance companies are about US$2 million\(^{25}\). Branch costs and minimum capital investment requirements were taken into consideration when calculating the insurance sector investment flow in the following table.

Table 3.4: Cross-Border Investment in the Insurance Sector

<table>
<thead>
<tr>
<th>Insurance Companies(^{26})</th>
<th>Branches in Tanzania</th>
<th>Branches in Uganda</th>
<th>Total Branches EAC</th>
<th>Est. Investment (US$ Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>APA Insurance</td>
<td>Reliance Insurance Co(^{27}): Dar es Salaam (1), Arusha (1), Mwanza (1)</td>
<td>None</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>ICEA</td>
<td>ICEA Uganda - Kampala</td>
<td>None</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Jubilee Insurance</td>
<td>Jubilee Tanzania: Dar es Salaam, Arusha, Mwanza, Mbeya, Zanzibar</td>
<td>Jubilee Uganda - Kampala</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>Real Insurance</td>
<td>Real Insurance Tanzania: Dar Es Salaam (2), Arusha (1), Mwanza (1)</td>
<td>None, but has a branch in Malawi</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>UAP Insurance</td>
<td>None, but have a branch in Southern Sudan – Juba</td>
<td>UAP Uganda, Lira (1), Mbarara (1), Mbale (1), Jinja (1), Kampala (1)</td>
<td>5</td>
<td>2</td>
</tr>
</tbody>
</table>

Total Estimated Investment

| 30 | 18 |

(iv) Stock Brokerages and Investment Banks

\(^{25}\) Consultations with UAP, APA and Phoenix of EA, estimated minimum capital requirements were approximately US$2 million in EAC

\(^{26}\) The minimum capital requirements for insurance companies in the region averages to US$2 million according to information from investment authorities in Uganda, Tanzania and Rwanda

\(^{27}\) APA Insurance is the largest shareholder of Reliance Insurance Co. Tanzania with 34% stake in the business. The company is not a fully owned subsidiary of APA Insurance.

\(^{28}\) Phoenix of East Africa also has branches in Rwanda. We’ve estimated their EAC branch network to be at least 11.
Several Kenyan stock broking firms have subsidiaries within the EAC region. These include, Dyer and Blair Investment Bank (Uganda and Rwanda), Faida Securities (Rwanda), and Kingdom Securities (Rwanda). Each of these stockbrokers has only one branch in the regional countries they operate in. Using information from Uganda Stock Exchange (USE) and Rwanda OTC we were able to estimate an approximate total intra-EAC investment flow in the range of US$40,000 - US$60,000 based on the licensing fees to the exchanges and minimum capital requirements to range between US$10,000 and US$15,000\textsuperscript{29}.

Total Financial Sector Investment

The above estimates lead to a conclusion that for the financial sector the total investment flow within the EAC region due to cross-border investment is about US$76.38 million, with the banking sub-sector contributing the bulk of the flow.

Table 3.5: Total Cross-Border Investment

<table>
<thead>
<tr>
<th>Financial Sub-Sector</th>
<th>Estimated Investment (US$) millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Banking</td>
<td>58.34</td>
</tr>
<tr>
<td>2. Insurance</td>
<td>18</td>
</tr>
<tr>
<td>3. Stock-broking</td>
<td>0.04</td>
</tr>
<tr>
<td>Total</td>
<td>76.38</td>
</tr>
</tbody>
</table>

(v) Private Capital Flows

The integration of the EAC stock exchanges is planned to take place in 2012. The first move to integrate the exchanges was to develop common automated trading and clearing platforms. This adoption is currently underway, with Uganda adopting the same automated trading system (ATS) that is used by Kenya, and Tanzania and Rwanda expected to follow suit (Burundi does not yet have a stock exchange).

\textsuperscript{29} Estimates based on information from USE and Rwanda OTC and Consultations with Dyer & Blair, CFC-Stanbic Financial services and African Alliance Securities.
Table 3.6: Cross-Listings in the EAC

<table>
<thead>
<tr>
<th>Cross – Listed Shares</th>
<th>Stock Exchange</th>
<th>Market Capitalization (US$ ‘000)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NSE</td>
<td>DSE</td>
</tr>
<tr>
<td>East African Breweries</td>
<td>USE, DSE, NSE</td>
<td>1,433,937.47</td>
</tr>
<tr>
<td>Kenya Airways</td>
<td>USE, DSE, NSE</td>
<td>132,329.733</td>
</tr>
<tr>
<td>KCB</td>
<td>NSE, USE, Rwanda OTC</td>
<td>582,536.267</td>
</tr>
<tr>
<td>Equity Bank</td>
<td>NSE, USE</td>
<td>661,562.8</td>
</tr>
<tr>
<td>Jubilee Group</td>
<td>DSE, NSE, USE</td>
<td>65,400</td>
</tr>
<tr>
<td>Total Cross-Listed Share Market Capitalization</td>
<td>2,875,766.27 (99.84%)</td>
<td>1,691.65 (0.06%)</td>
</tr>
</tbody>
</table>

Prior to implementation of a common trading platform, cross-listing of shares in the EAC is already occurring and has increased private capital flows within the region. The total market capitalization for cross listed shares in the EAC region stands at about US$2.88 billion with 99.84 percent being taken up by the NSE whilst 0.16 percent is shared between DSE and USE. All companies cross-listed and traded regionally are from Kenya. To date there have been no cross-listings of companies based in other EAC countries.

Foreign participation in some EAC markets is restricted by law (Box 1), but Kenya allows for greater foreign participation in its stock market than other member countries. All five members of the EAC do not have restrictions with respect to inward flow of capital but there are restrictions with respect to outward flow. Kenya and Uganda allow outward direct investment; Tanzania does not and Burundi and Rwanda require approval from the central bank. Rwanda intends to eliminate its requirement for central bank approval of outward investment by the end of 2009. Kenya defines a local investor as an EAC citizen and allows foreign participation of up to 75 percent. Tanzania allows foreign participation of up to 60 percent of shares in primary or secondary issues. There are no restrictions in Uganda or Rwanda.

Unlike Kenya, Tanzania does not allow foreign participation in IPOs. Rwanda and Uganda require citizens to seek approval from their central bank to buy foreign IPOs. Sale or issue of shares by foreigners is not restricted in Kenya, Uganda, and Tanzania but Rwanda requires central bank approval. There are no restrictions for foreigners to buy debt instruments in Kenya, Uganda, Rwanda and Burundi. Tanzania however restricts purchase of government bonds but allows foreign participation for corporate debt instruments.
CURRENT SITUATION IN REGARD TO FREE MOVEMENT OF CAPITAL IN EAC

By: Mr. Chris Mwebesa (Chief Executive – Nairobi Stock Exchange)

Uganda

- Uganda has no restrictions on foreign investors in its capital markets. East African Nationals and Residents are therefore treated the same as “foreigners.”

Rwanda

- Rwanda has no restrictions on foreign investors in its capital markets. East African Nationals and Residents are therefore treated the same as “foreigners.”

Kenya

- Kenya reserves 25% of the issued and fully paid up share capital of a listed company for East Africans (Kenya recognizes East Africans as Domestic/Local Investors).
- Kenya reserves 40% of shares issued during IPOs for East Africans.

Tanzania

- Tanzania reserves 40% of the issued and fully paid up share capital of a listed company for Tanzanian Nationals;
- Foreign Investment in Tanzanian Government Bonds or Treasury Bills is not permitted.
- Tanzanians are not permitted to invest abroad without case-by-case approval by the central bank, unless they are investing funds that have been earned overseas.
- The capital account in Tanzania is therefore not fully liberalized, to the extent that Tanzanian investors are constrained from investing in securities outside of Tanzania. The ramifications of this were witnessed during the recent Safaricom IPO.


The following table lists IPOs and bond issues within the region over the last two to three years, and approximate participation in these issues from each EAC country, as well as cross-listed stocks and their market capitalization with the various exchanges.
Table 3.7: Recent IPOs and Bond Issues in the EAC

<table>
<thead>
<tr>
<th>Regional Exchanges</th>
<th>Market Capitalization (million)</th>
<th>Regional IPOs (2006 – 2009) Funds Raised</th>
</tr>
</thead>
<tbody>
<tr>
<td>NSE – Kenya</td>
<td>US$ 10,303</td>
<td>- 2007: Kengen IPO Ksh 26 billion (US$412.7 million)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- 2008: Safaricom Ksh 51 billion (US$809.5 million)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- 2009: Kengen Infrastructure bond Ksh 26.5 billion (US$ 353.3 million)</td>
</tr>
<tr>
<td>DSE – Tanzania</td>
<td>US$ 3,979.12</td>
<td>- Tanzania Portland Cement</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- National Microfinance Bank</td>
</tr>
<tr>
<td>TOTALS</td>
<td>US$ 17,874.67</td>
<td></td>
</tr>
</tbody>
</table>

Participation in EAC stock and bond markets is usually dominated by institutional investors, national pension funds, fund management firms and insurance companies. Information provided by Kenyan investment banks estimates the participation of Kenyan investors in other EAC markets at about 10 percent, whereas that of Uganda investors in other EAC markets is between two and five percent, and of Tanzania a maximum of 0.5 percent. Due to the lack of restrictions on capital flows from Kenya, a greater number of its retail investors participate in EAC markets, and this contrasts to Tanzania and Uganda where mainly institutional investors participate. Indeed, in 2008 citizens from all EAC countries were able to participate in the Kenyan IPO of Safaricom with the same status as Kenyan local investors. EAC citizens were allowed to take up 40 percent allotment for local investors and pay 5 percent withholding tax on dividend income as opposed to the 10 percent that foreign investors are required to pay.

Using stock market turnover figures for 2008 and the investor participation estimates stated earlier (Ugandan participation at about 2%, Tanzanian at 0.5% and Kenyan 10%) capital market flows for each stock market were extrapolated. The result for each country’s participation in EAC markets is outlined below.

30 Market capitalization figures are from NSE, DSE and USE as of 30th October 2009
Regional capital market flows are estimated at US$44.6 million. Uganda accounts for US$25.82 million, Tanzania US$13.13 million and Kenya US$5.72 million. Kenya’s NSE accounts for 86 percent of total investment flow, Tanzania’s DSE one percent, and Uganda’s USE 13 percent. The NSE puts total foreign participation in the market to be 40 to 50 percent of market turnover during bear markets, and 20 to 30 percent during bull markets. These are largely international institutional investors, pension funds, frontier or emerging market funds, and some hedge funds. The NSE puts participation from other EAC partners at less than 5 percent of market turnover, and a comparison with actual NSE market turnover figures\textsuperscript{31} shows EAC participation to be 3 percent (2008) and 4% (2009).

Total capital markets flows are thus US$98.32 million divided between flows into already-listed stocks of US$44.6 million, and IPO’s and bond offerings of US$53.72 million.

(vi) Summary

These estimates reinforce the notion of Kenyan financial domination in the EAC. Given the development gap vis-a-vis financial markets in other partner states this is not surprising. The gap is further reinforced by the availability of skilled financial personnel in Kenya.

C. Cross-Border Banking in the EAC

(i) Introduction

Across SSA commercial banks have led the process of regional financial integration. Motivated by a range of factors, cross-border links in the banking sector have proliferated in various forms in recent years, and the links developed do not always conform to borderlines drawn by REC membership. The larger East Africa region (including southern Sudan and the eastern DRC as well as the EAC countries) has not differed in this regard. Several banks utilize – to a greater or lesser extent - a regional business model driven by a range of factors including client demand, banks own corporate structures, or by opportunities to access markets along the

\textsuperscript{31} NSE total market turnover, US$2.57 billion (2008) and US$1.98 billion (2009)
regional trade corridors. These banks display a fair degree of operational integration not just within EAC markets but throughout the larger East African region.

The growing presence of cross-border banks in the region raises the question about the inter-connectedness of EAC financial markets based on the extent of operational integration of bank subsidiaries: to what extent are banks already pooling resources/functions across subsidiaries and effectively operating as a single regional entity although EAC rules do not include single licensing or branching? To answer this and other questions we surveyed a number of banks with operations in more than one market in the EAC\textsuperscript{32}.

While our sample of banks that have a presence in more than one EAC member country is by definition limited in number, it is also a quite comprehensive. As part of the survey we interviewed most of the leading banks in East Africa. The institutions surveyed included banks domiciled in the EAC, and in other parts of Africa, Europe and the USA. These banks serve a range of clients ranging from top tier corporations to SMEs and retail clients. The response rate to the surveys was over 50 percent but a more serious concern was that not all the respondents answered all the questions. Given the small sample size it is necessary to restate the cautionary caveat on the inferences that are drawn.

(ii) Operational Integration

Of the banks interviewed 56 percent have their operations in the East African region hubbed, mostly in Kenya. Most of the banks surveyed have yet to achieve full integration of their operations in the region (Fig 3.2), but partial integration has taken place in the areas of ICT, risk management, customer service, and treasury operations. A few banks have not significantly integrated their operations with most of their operations carried out at the individual country level.

For the purposes of this report it is especially significant that two-thirds of the banks state that regionalization has facilitated the introduction of financial products and services that would not have been possible in the absence of scale.

Establishment of a single licensing regime (which would remove barriers to entry posed by separate capitalization requirements for each subsidiary and enable cross-border branching) is favored by a majority of the banks as a measure which would promote integration.

The major impediments to attaining full integration cited by banks are: the lack of a common tax regime; resistance from bank supervisors (particularly in Tanzania and Uganda, who are averse to banks under their jurisdiction being managed by Kenyan parents); IT connectivity problems (caused by weak physical infrastructure); regulatory requirements;

\textsuperscript{32} Details on the interviews with and questionnaires distributed to commercial banks are made available in Appendix 2.
restrictions on the mobility of labor; and, the existence of differing capital movement polices within the EAC.

Scale: 0 (low) to 5 (high)

Group Standard

89 percent of the banks interviewed have a group standard for the East Africa region and 78 percent have common process flows used within the region regarding IT platform, accounting systems, and human resource practices. 89 percent of the banks use a common credit approval and control systems within their regional subsidiaries. 67 percent of the banks use a similar asset/liability management practices within their regional subsidiaries.

Account Application Process
As figure 3.3 indicates 86 percent of the banks require clients from one country to undergo a separate application process to open an account in another EAC country. Only KCB allows for a single application process for different accounts in its regional subsidiaries. These requirements can largely be attributed to foreign exchange controls and/or capital account restrictions which hamper banks’ ability to serve clients on a regional basis. Nevertheless, during interviews several banks indicated that they do have an informal information sharing system and that a client’s history with one subsidiary in the region does inform his/her dealings with another.

Forex Controls & Capital Account Restrictions

![Figure 3.4: Extent to which forex controls & capital a/c restrictions hamper serving clients on a regional basis](image)

*Scale: 0 (low) to 5 (high)*

Figure 3.4 depicts the levels to which foreign exchange controls hinder banks from serving clients on a regional basis. Tanzanian banks cited the most difficulties.

**Scale Benefits**

67 percent of banks interviewed indicated that their presence in more than one EAC country has enabled the bank to achieve the operational scale required to introduce financial products which would not be viable in one country alone. Key products include: commodity derivatives, retail products, ATM & VISA card services, investment banking services and structured finance as well as non-interest banking.
Scale: 0 (low) to 5 (high)

Figure 3.5 depicts the extent to which differences in regulations prevent introduction of mass credit products. Most banks (44 percent) do not regard differences in regulations as a hindrance to the introduction of mass credit products 20 percent though felt that this was a significant problem (3 or greater on the scale).

Barriers to Integration
Figure 3.6 depicts the extent to which EAC banks find single licensing important to further integration. A large majority (67 percent) felt that licensing was extremely important. Only 20 percent of the banks felt that it was not important.

Additionally, when asked what they felt to be the single most significant barrier to further operational integration, the responses were diverse and included:

- Lack of a common tax regime
- Regulatory requirements
- Communication Links
- Labour turnover
- Three different central banks

Figure 3.7 illustrates that 34 percent of the banks perceive unfavorable regulatory framework as a major barrier to operational integration. Unclear tax laws, labour turnover, and poor IT connectivity are each regarded by 22 percent of the banks as major barriers to operational integration.
Trade Between Country Offices/Subsidiaries

All the banks maintain nostro\(^{33}\) accounts in East Africa. Most banks have up to six nostro accounts each. Typical transactions include trade accounts, interbank trade, carry trade, loan payments, investment accounts, and education transactions. Trade accounts typically saw the most activity in this context. (see fig. 3.8).

![Figure 3.8: Types of Transactions between EAC Banks](image)

Data provided on the volume and value of transactions within the EAC was not sufficient to reach any definitive conclusions, but the data received from a few banks is illustrative. The average size of transactions ranged from as low as US$500 to as high as US$20,000. The highest monthly volume of transactions was from Kenya to Tanzania for one bank amounting to US$2 million.

Central Bank Supervision

Only 22 percent of the banks have had their operations supervised by a central bank in another country in the region in addition to supervision by the host country’s central bank. However, of those supervised in this way, the additional supervision only consisted of routine inspections (this only occurred in Tanzania) and filing of compliance reports, and this additional supervision has not had a negative impact on the banks’ business operations. Only one bank has

\(^{33}\) A nostro account is one that a bank holds with a foreign bank. Typically, nostro accounts are in the currency of the foreign country to allow for transactional ease.
reported incurring additional costs as a result of differences in regulatory reporting requirements between different EAC countries.

**D. Going Forward**

Several factors have come together to propel the regionalization of financial markets in the EAC. The signing of the CMP and the initiatives of the private sector banks together create a favorable climate for further integration, especially between the three original members of the EAC (issues pertaining to the integration of Rwanda and Burundi are dealt with separately in the following section). However, several factors still constrain the growth and integration of the regional market. At the same time there is reason to stay alert to the risks that come with increasing cross-border financial links. Thus, the path forward should involve taking steps that on the one hand facilitate the movement of funds between EAC members, and on the other ensure a more careful tracking of the volumes and consequences of these flows:

- **Harmonization of legal and regulatory frameworks:** The banks surveyed cited differential tax regimes and other regulatory discrepancies as a major hindrance to further integration. Further work needs to be done to align regulatory and supervisory frameworks and reporting requirements to address this issue.

- **Mutual recognition among regulators:** Adopting single-licensing will have to be accompanied by mutual recognition among regulators and this will require that national regulators converge around some broadly defined international principles such as the Basle core principles for bank supervision, IOSCO, and others.

- **Adopting single licensing regime.** Banks surveyed during in the preparation of this report cite single licensing as an important aid to further integration. If introduced for banks, single licensing should also be extended to other market participants such as brokers and insurance companies in order to significantly reduce cross-border transaction times and costs and barriers to entry.

- **Building-up regionally compatible financial infrastructure.** Kenya, Tanzania and Uganda have already made substantial progress in integrating their RTGS. Rwanda and Burundi also need to align their payments systems with the regional system. Similarly, it is necessary to ensure that other parts of national financial infrastructure, including CSDs and trading platforms for national exchanges, are compatible at the regional level.
• **Strengthening cross-border supervisory practices:** Deepening links between financial institutions warrant a similar deepening of cooperation between supervisors. As indicated by surveyed banks instances of scrutiny by supervisors in other countries are rare. Home-host supervisory communication, consolidated supervisions are important to ensuring that weaknesses in one financial institution/market do not put the regional financial system at risk.

• **Strengthening data gathering.** Information on current volumes of cross-border trade in financial products is generally sketchy and incomplete. This data gap is problematic, not just in that policymakers are working with limited information on the issues and opportunities that lie ahead, but also in that it also masks the benefits and costs of further integration by obscuring the extent of cross-border linkages. Porous borders, high volumes of unrecorded informal trade, and the widespread use of physical cash in transactions, further compound these issues. There is ample scope to build additional capacity on this front both at the national level and at the EAC Secretariat.

4. **Burundi & Rwanda in the Context of the EAC Financial Sector**

A. **Overview**

The financial sectors in both Burundi and Rwanda are at a lower level of development than those in other EAC countries: in Burundi, the financial sector consists of seven banks, of which three are commercial banks, with four very small insurance companies; in Rwanda, the 12 banks operating also dominate the financial sector, but with a more developed insurance sector compared to Burundi. Overall, the financial sector in Rwanda is larger, offers a broader range of financial services and products (Table 4.1), and is developing faster than Burundi’s. The degree of cross-border banking sector integration with the rest of the EAC is also higher in Rwanda than in Burundi, with three EAC-headquartered banks operating in Rwanda versus one in Burundi.

![Figure 4.1: Rwanda and Burundi GDP Growth, 2003-10](image-url)
As shown in Table 4.2, the banking sectors in Burundi and Rwanda are relatively weaker than those in the three other EAC countries, with lower capital adequacy, higher nonperforming loan ratios, and lower return on assets. The profitability picture is more mixed, with both Rwanda and Burundi seeing returns on equity which fluctuate above and below the EAC average (however, it should be borne in mind that even the lowest return on equity experienced by the two banking systems in recent years - 15.5 percent in 2006 - still reflects substantial profitability). Compared to the other EAC countries, Rwanda has a significantly higher levels of private sector credit relative to liquidity (expressed as broad money) in its financial system, while Burundi is average for the region, but overall the level of banking system assets relative to GDP is extremely low in both absolute terms and relative to other EAC countries.

### Table 4.1: Comparison of Availability of Selected Financial Services

<table>
<thead>
<tr>
<th>Stock Market</th>
<th>Commercial Banking Services</th>
<th>Corporate Bond Market</th>
<th>Government Debt Market</th>
<th>Casualty Insurance</th>
<th>Life &amp; Other Insurance</th>
<th>Private Pensions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Burundi</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kenya</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rwanda</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tanzania</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Uganda</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Table 4.2: Cross-EAC Comparison of Key Banking Ratios

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Burundi</th>
<th>Kenya</th>
<th>Rwanda</th>
<th>Tanzania</th>
<th>Uganda</th>
<th>EAC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Adequacy Ratio</td>
<td>13.5</td>
<td>16.5</td>
<td>13.7</td>
<td>16.3</td>
<td>18.0</td>
<td>15.6</td>
</tr>
<tr>
<td>NPLs to Gross Loans</td>
<td>18.6</td>
<td>21.3</td>
<td>25.0</td>
<td>6.8</td>
<td>2.9</td>
<td>14.9</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>1.7</td>
<td>2.8</td>
<td>2.4</td>
<td>3.9</td>
<td>3.4</td>
<td>2.8</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>17.5</td>
<td>28.6</td>
<td>27.0</td>
<td>26.7</td>
<td>28.3</td>
<td>25.6</td>
</tr>
</tbody>
</table>

#### 2006

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Burundi</th>
<th>Kenya</th>
<th>Rwanda</th>
<th>Tanzania</th>
<th>Uganda</th>
<th>EAC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Adequacy Ratio</td>
<td>13.5</td>
<td>18.0</td>
<td>16.6</td>
<td>16.2</td>
<td>19.5</td>
<td>16.8</td>
</tr>
<tr>
<td>NPLs to Gross Loans</td>
<td>18.8</td>
<td>10.9</td>
<td>18.1</td>
<td>6.3</td>
<td>4.1</td>
<td>11.6</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>2.3</td>
<td>3.0</td>
<td>1.5</td>
<td>4.7</td>
<td>3.9</td>
<td>3.1</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>26.4</td>
<td>27.5</td>
<td>15.5</td>
<td>29.0</td>
<td>31.4</td>
<td>26.0</td>
</tr>
</tbody>
</table>

#### 2007
### 2008

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Adequacy Ratio</td>
<td>15.2</td>
<td>18.9</td>
<td>15.9</td>
<td>14.9</td>
<td>20.7</td>
<td>17.1</td>
</tr>
<tr>
<td>NPLs to Gross Loans</td>
<td>14.6</td>
<td>8.4</td>
<td>12.6</td>
<td>6.2</td>
<td>2.2</td>
<td>8.8</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>2.3</td>
<td>2.8</td>
<td>2.3</td>
<td>3.8</td>
<td>3.5</td>
<td>2.9</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>29.7</td>
<td>25.2</td>
<td>18.0</td>
<td>23.1</td>
<td>25.0</td>
<td>24.2</td>
</tr>
</tbody>
</table>

Sources: Central Bank of Kenya, Central Bank of Tanzania, Bank of Uganda, Bank of Burundi, Bank of Rwanda, IMF, World Bank

### B. Burundi

(i) Views of the EAC

Interviews conducted with the Burundian financial and business communities conveyed a sense of resignation rather than enthusiasm towards EAC membership. There is acute awareness that Burundi’s low level of development means that the consequence of membership is likely to be a substantial increase in competition from larger and better capitalized firms and financial institutions based in more advanced EAC countries – particularly Kenya – which businessmen, in particular, saw as likely to drive them out of business. Despite this, the view that “Burundi had no choice but to join” prevailed. Interviews indicated that given Burundi’s geographical position, its economic future would have to be based on three pillars: agriculture and associated food processing activities; tourism; and the trans-shipment trade between the rest of the EAC and the southern Congo, Tanzania and Zambia via Lake Tanganyika. To a large extent this strategy corresponds to that of Rwanda, with only the direction of the trans-shipment trade adjusted for the two countries relative geographic position.

In the banking sector, the impact of the EAC was seen chiefly in a rise in trade payments (primarily to Kenya and Rwanda) and increasing levels of transshipment trade related business (seen in increasing volumes of cash US dollar transactions). Within the sector, there was wide expectation that competition would increase, with Kenya Commercial Bank, Access Bank, Stanbic and Barclays identified as likely to be quick to open Burundi operations, and as a result also recognition that Burundian banks would need more capital to meet competition (a view which was confirmed by the BRB which indicated that it is considering increasing the minimum capital requirement to US$10 million).

At an official level, attitudes towards convergence with the EAC were very positive (reflecting in part a strong political commitment at the highest level to the EAC project) but emphasized the major challenges posed by Burundi’s lack of all types of capacity. In the
financial sector, the National Bank of Burundi (BRB) would be well served by adapting legislation and regulations prepared by the Bank of Rwanda (BOR): the BOR has significantly greater capacity than the NBB; is working from a similar civil law and French language heritage; and, is determined to adopt “best international practice” as part of its strategy to make Rwanda a preferred place to invest and do business in East and Central Africa. By adapting the work performed by the BOR, the BRB could compensate for its lack of capacity, accelerate the process of harmonization, and create a space for investment into which Rwanda-headquartered investors can expand in search of scale economies.

Close cooperation between the two central banks has been recommended by the IMF but not yet supported by financing from either the IMF or World Bank, and the BRB clearly believes that without the “push” provided by a joint project financed by the World Bank the sensitivities related to sovereignty which following such a strategy touch will prevent deepening and institutionalizing the level of Burundi/Rwanda legal and regulatory integration and cross-border supervisory cooperation. This report below recommends such a joint project financed by the World Bank and other donors.

(ii) The Financial Sector

Burundi’s financial sector is dominated by a small banking system (Table 3.3) consisting of seven commercial banks (of which two are majority state owned), two finance houses (both state owned), and a state development bank; and, four very small insurance companies, of which one is majority state-owned (Table 2.5). Burundi has the least developed financial sector in the EAC, with total banking system assets of US$288 million (24.8 percent of GDP) and total insurance premiums of US$ 12 million (1.02 percent of GDP) at year-end 2008.

The very modest role of the banking system as a source of finance for the economy is highlighted by a share of loans to GDP of only 6.32 percent. In addition to the banking and insurance sectors, a market for government debt has been created by the BRB, and appears to function well with all banks and insurance companies plus the social security fund investing, but there is no commercial bond issuance or stock exchange. The payments system is outdated, with a clearing system operated by the BRB which is only semi-computerized, slow, and prone to breakdowns.

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34 Considerable difficulty has been experienced in obtaining accurate and up-to-date data on the Burundi banking system (even the BRB does not publish current data and does not have a website) both during and after the team’s site visit. In the insurance sector, the only data obtainable was from the insurance companies themselves. As a result, all figures in this section should be treated with appropriate caution and treated as estimates only.

35 A fifth insurance company (SOGEAR) is licensed but completely inactive.
### Table 4.3: Snapshot of the Burundi Banking System

<table>
<thead>
<tr>
<th>Item</th>
<th>2007</th>
<th>2008</th>
<th>2007</th>
<th>2008</th>
<th>Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(USUS$ Millions)</td>
<td>(BIF Millions)</td>
<td></td>
<td></td>
<td>2007 - 08</td>
</tr>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans</td>
<td>94.7</td>
<td>123.9</td>
<td>116,690</td>
<td>152,697</td>
<td>30.86%</td>
</tr>
<tr>
<td>Other Earning Assets</td>
<td>80.2</td>
<td>109.5</td>
<td>98,816</td>
<td>134,932</td>
<td>36.55%</td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>16.3</td>
<td>17.4</td>
<td>20,034</td>
<td>21,494</td>
<td>7.29%</td>
</tr>
<tr>
<td>Non-Earning Assets</td>
<td>29.9</td>
<td>36.7</td>
<td>36,880</td>
<td>45,267</td>
<td>22.74%</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>221.1</strong></td>
<td><strong>287.7</strong></td>
<td><strong>272,419</strong></td>
<td><strong>354,389</strong></td>
<td><strong>30.09%</strong></td>
</tr>
<tr>
<td><strong>Liabilities &amp; Equity</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposits &amp; Short term Funding</td>
<td>182.4</td>
<td>232.5</td>
<td>224,676</td>
<td>286,381</td>
<td>27.46%</td>
</tr>
<tr>
<td>Other (Non-Interest Bearing)</td>
<td>18.9</td>
<td>27.3</td>
<td>23,306</td>
<td>33,652</td>
<td>44.39%</td>
</tr>
<tr>
<td>Equity</td>
<td>19.8</td>
<td>27.9</td>
<td>24,438</td>
<td>34,356</td>
<td>40.59%</td>
</tr>
<tr>
<td><strong>Total Liabilities &amp; Equity</strong></td>
<td><strong>221.1</strong></td>
<td><strong>287.7</strong></td>
<td><strong>272,419</strong></td>
<td><strong>354,389</strong></td>
<td><strong>30.09%</strong></td>
</tr>
<tr>
<td><strong>Loans/Deposits &amp; Short Term</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Funds</td>
<td>51.94%</td>
<td>53.32%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Assets/GDP</td>
<td>22.56%</td>
<td>24.80%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans/GDP</td>
<td>9.66%</td>
<td>10.68%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Sources:* World Development Indicators, Bankscope, World Bank

(iii) **Banking Sector Snapshot**

The Burundi banking sector has grown quickly in recent years but remains well capitalized with estimated capital to risk assets of above 14 percent at end-2008, highly profitable, and stable. Asset quality has improved since 2005, with the share of nonperforming loans to total loans falling from 20 percent in 2005 to 15 percent by end-2008. Despite recent growth, the banking sector is largely irrelevant to most Burundians who have minimal levels of access to the formal banking system: in 2006 less than two percent of the population had bank

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36 The figures in this table are derived from Bankscope. The data are incomplete and should thus be treated only as indicative of trends in the market.

accounts and only four percent were members of microfinance institutions. Even within the banking sector, access to credit is restricted with about 60 percent flowing to large corporate borrowers and less than 25 percent to small and medium sized enterprises. The commercial banks are not involved in agricultural finance, with financing from this sector coming only from the state development bank.

Table 4.4: Structure of the Burundi Commercial Banking Market in 2008

<table>
<thead>
<tr>
<th>Bank</th>
<th>Total Assets (US$ Thousands)</th>
<th>Total Loans</th>
<th>Total Deposits</th>
<th>Market Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>BCB</td>
<td>116,170</td>
<td>41,551</td>
<td>95,264</td>
<td>40.39% 33.52% 40.98%</td>
</tr>
<tr>
<td>Ecobank</td>
<td>19,186</td>
<td>9,126</td>
<td>13,646</td>
<td>6.67% 7.36% 5.87%</td>
</tr>
<tr>
<td>Interbank Burundi</td>
<td>152,297</td>
<td>73,265</td>
<td>123,542</td>
<td>52.94% 59.11% 53.15%</td>
</tr>
<tr>
<td>Total</td>
<td>287,653</td>
<td>123,942</td>
<td>232,452</td>
<td>100.00% 100.00% 100.00%</td>
</tr>
</tbody>
</table>

Source: Bankscope, World Bank Analysis

(iv) Banking Supervision & Regulation

The banking sector is regulated and supervised by the BRB. By comparison to other EAC countries bank regulation and supervision in Burundi is somewhat old fashioned: other EAC bank regulators have now moved ahead with implementation of risk based supervision while the BRB remains focused on monitoring regulatory compliance and is substantially noncompliant with the Basle core principles for banking supervision. Interviews with the BRB indicated that the central bank is well aware that it lags behind other EAC countries, but also that the BRB is working to catch up: formal memorandums of understanding are in place with all the other EAC central banks and the first formal information sharing agreement had been put in place with the Central Bank of Kenya.

38 Burundi Investment Climate Assessment 2006 (World Bank).
40 See previous note.
41 Burundi Financial Sector Assessment July 2009, op cit. Burundi fully complied with only one principle, somewhat compliant with five principles, and largely noncompliant with 12 principles, and noncompliant with six.
42 “…BRB lags behind the central banks of other [EAC] member countries….All countries except Burundi have introduced risk based banking supervision….All four other countries have adopted a strategic approach to payments system development and harmonization between the countries is underway. Burundi is just starting the reform process. Four countries have designed a five year financial markets development plan.Burundi has just launched this exercise.” Burundi Financial Sector Assessment July 2009, op cit.
The BRB also noted that it is joining common EAC training programs for supervisors and is preparing to procure technical assistance for transitioning the banking system to IFRS. Cooperation with the BOR is seen as a potential means of accelerating the modernization and harmonization of supervision and regulation, but at a practical level both countries are proceeding at their own pace and according to their own plans; the BRB (at a senior level) was of the view that while close cooperation with the BOR would be in the BRB’s interest, this objective could not be achieved without an external “push” via a joint project financed by a donor.

The BRB also expressed a strong desire for assistance in modernizing and integrating its payments system with the rest of the EAC, but indicated that it does not have the resources to do so at the present time. In this context, the BRB’s payments department had visited the BOR to discuss BOR’s procurement of a new payments system incorporating automated clearing house, real time gross settlement, and card capacities. The BRB intends to procure a compatible system which would allow the two systems to be linked together and thus permit cross-border automated payments with, possibly, Rwanda’s system functioning as a regional payments switch.

(v) Insurance Sector Snapshot

The insurance sector is extremely small in both absolute terms and in relation to GDP (Table 3.5) and offers only casualty products, including term life insurance, but with the automobile insurance business dominating (46 percent of premiums paid in 2008). At least one firm (SOCAR) is offering a pension product, but described response to its offering as very limited. One insurance firm CEO pointed out that “the whole sector is the equivalent of only one small Kenyan insurance company”. Insurance firms confirmed that additional business is been done (in theory illegally) by Rwanda-based insurance companies, with insurance coverage for mobile telephone towers being cited as an example. Rwanda participates in the COMESA “Yellow Card” international auto insurance scheme, which Burundian firms described as functioning well, if slowly. The insurance firms have formed an insurance association (ASSUR), and by mid-2008 the association had so far held one meeting with its Rwandan counterpart.

The sector is dominated by the partly (55 percent) state-owned SOCABU which enjoys a near-monopoly of government and state owned enterprise business, in part due to its shareholdings in these firms. Other firms concentrate on the private sector, including providing casualty insurance for banks. All of the insurance firms expected competition to increase in the future as a result of new entrants from Kenya, and expected to have to increase their capital in response. Given the lack of supervision and regulation (discussed below) the amounts of capital required would be determined by the firms themselves according to their own commercial criteria.
(vi) Insurance Supervision & Regulation

The insurance market is *de facto* unregulated: an insurance law was passed in 2002 which provided for the appointment of ARCA, and two individuals have been successively appointed as Commissioner. However, despite the provision of budget funding for ARCA in 2004 no insurance regulations (except for a regulation requiring firms to pay fees to ARCA itself) have been issued to implement the Insurance Act and there are no insurance supervisors. All four insurance firms expressed a consensus that ARCA “does not exist” and, simultaneously, expressed a desire to have a functioning and independent regulator with capable supervisors. The increasing threat of intra-EAC competition may be one factor in the sector’s desire to have a functioning regulator; a second factor may be the desire to have a more level playing field for the three private firms competing with SOCABU.
The World Bank has recommended that insurance regulation and supervision responsibilities be moved to the BRB. Insurance firms themselves were divided regarding this recommendation: the largest endorsed BRB taking over while the smaller firms preferred an independent regulator, provided it could be effective. Both the BRB and insurance firms commented that technical assistance would be required to help develop insurance supervision capacity at the BRB. As with banking regulation, there is a strong case to be made for close cross-border cooperation on insurance supervision and regulation between Burundi and Rwanda (not least because cross-border insurance business is already reported to be taking place). This is reinforced by the very small size of the sector in Burundi which implies that the ability of the sector to pay for supervision will be very limited: as recommended below, consideration should be given to setting up a single regulator for both countries to secure sufficient scale to allow effective supervision.

C. Rwanda

(i) View of the EAC

In contrast to Burundi, interviews with participants in the Rwandan financial sector showed a much stronger commitment to the EAC. This difference in attitude was, in part, clearly linked to commitment to the Government’s “African Switzerland” development strategy. This strategy calls for Rwanda to become the domicile of choice for firms investing in the EAC by providing an environment characterized by a combination of: high quality business-friendly law and regulation; impartial and sophisticated supervision; an uncorrupted judicial system and bureaucracy; and, significant improvements in physical infrastructure (transport and telecommunications links) to take advantage of Rwanda’s position as a transshipment point between East and Central Africa. Foreign banks in particular highlighted the relatively uncorrupt business environment and quality of supervision as a factor in choosing to open operations in Rwanda, but also highlighted continuing problems with telecommunications infrastructure as a significant problem.

Within the financial sector, this commitment to the EAC was evidenced by the generally welcoming regulatory attitude towards incoming banks (whether from the EAC or from other parts of Africa) and a strong desire to see a regional capital market come into being. Rwanda’s chairmanship of the EAC Monetary Affairs Committee in 2009 was also seen as an opportunity to push forward the integration agenda, with the only complaints about the EAC being claims other countries are behind Rwanda in modernizing their regulatory frameworks. Foreign banks indicated that the licensing process to enter Rwanda had been fairly straightforward, and

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43 IFC is supporting a project directed at creating a regional bond market.
contrasted this unfavorably with Burundi. Foreign banks also noted that Rwanda is implementing the EAC’s free movement of labor protocol, and have been able to bring in staff from their home countries without any problems (interestingly, some Burundian financial sector firms also stated they intend to use this right to hire better-skilled staff from elsewhere in the EAC). Somewhat surprisingly - and in marked contrast to Burundian financial sector institutions - Rwandan domestic banks and insurance companies were also positive about the impact of EAC membership on their business, seeing opportunities to raise additional capital and access a much larger market, including possibly expanding cross-border.

Interviews with Rwandan regulators indicated that there is a strong awareness of the impact of a lack of scale in their home market on the ability to provide quality supervision. Both the regulators (CMAC and BOR) expressed considerable openness to the possibility of setting up joint Burundi/Rwanda regulatory bodies, and both emphasized the importance of adopting uniform banking, insurance, payments, and securities laws across the EAC. Both regulators also specifically emphasized the importance of Rwanda pursuing compatible hardware and software solutions for payments and securities trading and settlement systems to allow markets to be more easily integrated. This openness may offer opportunities to promote “win/win” joint solutions for increasing supervisory capacity in both countries, allowing Rwanda to secure the benefits of larger scale while allowing Burundi the opportunity to accelerate reforms by taking advantage of regulatory reforms already advanced in Rwanda (which is starting from a similar civil law framework).

(ii) The Financial Sector

Rwanda’s financial sector is dominated by the banking system which at end-2009 consisted of 9 commercial banks (of which one is majority state owned and all of the remainder have either a majority or a significant percentage of foreign ownership), one housing bank (majority state-owned with full banking license), a state owned development bank (also with a commercial banking license); and, five commercial insurance companies providing property, life and casualty coverage, plus one non-social medical insurance company. In addition to the banking and insurance sectors, a capital market has also been established, with one domestic corporate bond issued in addition to Government bonds, a planned cross-border share listing (Kenya Commercial Bank), and hopes for two or three domestic share listings by the end of 2010.

44 Bank of Kigali. An attempt was made to privatize (presumptively to a foreign strategic investor) Bank of Kigali in 2008 but abandoned in the face of adverse market conditions caused by the global financial crisis.
45 The Rwandan Housing Bank is being converted into a wholesale housing refinance institution with support from IFC.
46 The Rwanda Development Bank (BRD). In 2008 the African Development Corporation acquired 25 percent of BRD.
(iii) Banking Sector Snapshot

The Rwanda banking sector (Tables 3.6 and 3.7) has grown quickly in recent years, with total assets increasing from RWF 221 billion to RWF 501 billion\(^{47}\) from end-2005 to end-2008 (an increase of 231 percent in nominal terms), with a significant portion of this growth taking place in 2008\(^{48}\). Loan growth slowed significantly in 2009 due to increasing liquidity constraints in the system because deposits had failed to expand in line with lending\(^{49}\), when total assets increased by 33 percent. Despite rapid growth, the system remains well capitalized with estimated capital to risk assets of at 17.7 percent at in June 2009. The risk posed by asset quality also decreased due to better provision coverage, with the share of net (of provisions) nonperforming loans to total loans falling from 9.8 percent in June 2008 to 7.5 percent in June 2009\(^{50}\).

Table 4.6: Snapshot of the Rwanda Banking System\(^{51}\)

<table>
<thead>
<tr>
<th>Item</th>
<th>2005 (Million RWF)</th>
<th>2006 (Million RWF)</th>
<th>2007 (Million RWF)</th>
<th>2005 (Million US$)</th>
<th>2006 (Million US$)</th>
<th>2007 (Million US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>16,455</td>
<td>33,496</td>
<td>84,585</td>
<td>29</td>
<td>59</td>
<td>148</td>
</tr>
<tr>
<td>Interbank Placements</td>
<td>61,505</td>
<td>76,255</td>
<td>51,763</td>
<td>108</td>
<td>133</td>
<td>91</td>
</tr>
<tr>
<td>Securities</td>
<td>32,160</td>
<td>42,142</td>
<td>51,862</td>
<td>56</td>
<td>74</td>
<td>91</td>
</tr>
<tr>
<td>Loans</td>
<td>91,801</td>
<td>120,127</td>
<td>162,478</td>
<td>161</td>
<td>210</td>
<td>284</td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>15,106</td>
<td>16,251</td>
<td>17,643</td>
<td>26</td>
<td>28</td>
<td>31</td>
</tr>
<tr>
<td>Other Assets</td>
<td>4,246</td>
<td>5,412</td>
<td>16,452</td>
<td>7</td>
<td>9</td>
<td>29</td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td>221,273</td>
<td>293,683</td>
<td>384,783</td>
<td>387</td>
<td>514</td>
<td>674</td>
</tr>
<tr>
<td>Local Currency Deposits</td>
<td>136,234</td>
<td>183,913</td>
<td>247,946</td>
<td>238</td>
<td>322</td>
<td>434</td>
</tr>
<tr>
<td>FX Deposits</td>
<td>52,326</td>
<td>70,900</td>
<td>83,171</td>
<td>92</td>
<td>124</td>
<td>146</td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>11,912</td>
<td>11,655</td>
<td>13,714</td>
<td>21</td>
<td>20</td>
<td>24</td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES</strong></td>
<td>200,472</td>
<td>266,468</td>
<td>344,831</td>
<td>351</td>
<td>466</td>
<td>604</td>
</tr>
<tr>
<td>Capital</td>
<td>20,801</td>
<td>27,216</td>
<td>39,952</td>
<td>36</td>
<td>48</td>
<td>70</td>
</tr>
</tbody>
</table>

\(^{47}\) Data on the composition of the consolidated balance sheet at end-2008 of the banking system is not available.

\(^{48}\) Despite its larger absolute size, at end-2008 the total assets of the Rwandan banking system were smaller in relation to GDP at about 18 percent versus nearly 25 percent in Burundi.

\(^{49}\) Source: IMF.


\(^{51}\) Latest available consolidated data from Bank of Rwanda.
## TOTAL LIABILITIES & EQUITY

<table>
<thead>
<tr>
<th></th>
<th>221,273</th>
<th>293,684</th>
<th>384,783</th>
<th>387</th>
<th>514</th>
<th>674</th>
</tr>
</thead>
</table>

### Loans/Deposits & Short Term Funds

<table>
<thead>
<tr>
<th></th>
<th>48.69%</th>
<th>47.14%</th>
<th>49.07%</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th></th>
<th>16.14%</th>
<th>18.17%</th>
<th>19.75%</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th></th>
<th>6.70%</th>
<th>7.43%</th>
<th>8.34%</th>
</tr>
</thead>
</table>

Source: National Bank of Rwanda, Bank Supervision Department

### Table 4.7: Recent Financial Soundness Indicators of the Rwandan Banking System

<table>
<thead>
<tr>
<th>Indicator</th>
<th>31-Mar-09</th>
<th>31-Dec-08</th>
<th>31-Mar-09</th>
<th>30-Jun-09</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Adequacy Ratio</td>
<td>18.0%</td>
<td>15.9%</td>
<td>191.0%</td>
<td>17.7%</td>
</tr>
<tr>
<td>Net NPLs/Net Loans</td>
<td>9.8%</td>
<td>10.5%</td>
<td>10.5%</td>
<td>7.5%</td>
</tr>
<tr>
<td>Provisions/NPLs</td>
<td>75.5%</td>
<td>66.3%</td>
<td>66.9%</td>
<td>67.0%</td>
</tr>
<tr>
<td>ROA</td>
<td>2.7%</td>
<td>2.4%</td>
<td>1.6%</td>
<td>0.9%</td>
</tr>
<tr>
<td>ROE</td>
<td>21.9%</td>
<td>18.5%</td>
<td>11.8%</td>
<td>6.4%</td>
</tr>
<tr>
<td>Net Interest Margin</td>
<td>8.9%</td>
<td>9.5%</td>
<td>10.3%</td>
<td>10.2%</td>
</tr>
<tr>
<td>Overhead/Income Ratio</td>
<td>46.7%</td>
<td>48.6%</td>
<td>52.2%</td>
<td>53.4%</td>
</tr>
<tr>
<td>Liquid Assets/Deposits</td>
<td>60.4%</td>
<td>61.1%</td>
<td>65.4%</td>
<td>56.6%</td>
</tr>
<tr>
<td>Gross Loans/Deposits</td>
<td>76.2%</td>
<td>87.8%</td>
<td>88.6%</td>
<td>82.8%</td>
</tr>
</tbody>
</table>

(iv) Banking Supervision & Regulation

Banking, microfinance, and pensions are all regulated and supervised by the BOR Financial Stability Department, and the BOR also operated the credit reference bureau. The capital market is supervised by the Capital Markets Advisory Commission (CMAC), reporting to the Ministry of Finance (see following section). The BOR has signed memorandums of understanding with the other EAC bank regulators and is a strong advocate of intra-EAC cooperation, reflecting the high level Government commitment to integration. At a senior level, BOR officials indicated that Rwanda appreciates the problems posed by scale in providing the high quality bank regulation and supervision environment need for the country’s financial sector.

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strategy, and as a consequence would not view negatively a proposal for forming unified supervisory institutions. On the other hand, the presence of banks from non-EAC countries (e.g. Nigeria) has raised some concerns due to the difficulty experienced in establishing similar arrangements for supervisory cooperation.\textsuperscript{53}

The BOR and the Government have been working to modernize the supervision and regulation of the banking sector by harmonizing with the Basle core principles. This has been supported by the adoption of IFRS for banks (all listed companies will also have to comply with IFRS) and a new Banking Law. In parallel, the BOR has been reviewing its regulations to ensure compatibility with other EAC countries. Harmonization of reporting requirements for banks (an important issue for banks due to the duplication of reporting costs due to varying requirements across the EAC\textsuperscript{54}) is under review by the EAC Secretariat, and further action to harmonize these requirements has been put on hold pending the outcome of this study. Interviews with banks indicated that the standard of bank supervision is high as compared to most other EAC countries, and the BOR was described as a strong but fair supervisor.\textsuperscript{55}

(v) Securities Market

CMAC was established in 2007 to promote the development of capital markets in Rwanda, and by 2009 had established over-the-counter (OTC) markets in Government and commercial bonds. CMAC’s board consists of representatives from the Government, private sector, and the BOR. Eight brokerages are licensed to do securities business. The securities regulatory framework is still under development, with a Capital Market Commission Act (which would establish the CMAC as the securities regulator) and the Capital Market Act both submitted to the Government but pending enactment. As of early 2010, in addition to these two bills, additional bills covering electronic payments, collective investment schemes, and the central securities depository were all also pending enactment. Delays in enacting these laws have

\textsuperscript{53} Since mid-2009 Nigeria in particular is making efforts to set up such cooperation arrangements. The emergence of the Nigerian banking crisis in July 2009 highlighted the importance of providing good information to supervisors where Nigerian banks have subsidiaries.

\textsuperscript{54} One foreign bank noted that in Kenya the reporting requirements are both more rigorous than in Rwanda and that Kenyan reporting is still done manually. Reporting in Rwanda is cheaper not only because it is simpler but, more importantly, because the BOR accepts electronic filing.

\textsuperscript{55} How much progress has been made by the BOR in recent years is clear from an IMF review of financial stability conducted in 2005 which commented: “banking supervision operates in an environment characterized by high vulnerability to external shocks; a concentration of economic activity in a few sectors; a weak credit culture among banks and their customers; the lack of normalized accounting standards and appropriate auditing rules for the non financial sector; weaknesses in the legal and judicial frameworks; weak corporate governance, including in some commercial banks; and a lack of human capital in the sector as well as in the accounting and auditing profession.”

been identified as obstructing the development of the capital markets\textsuperscript{56}, and the authorities accordingly need to accelerate efforts to secure passage.

The Rwanda OTC opened in 2008, with four Government bonds and one corporate bond being listed by mid-2009. The CMAC is also actively promoting equity issuance. In 2009 the first a cross-listing of a share was achieved with the Nairobi Stock Exchange-listed Kenya Commercial Bank (which opened a subsidiary in Rwanda in 2009), and the CMAC is seeking a further cross-listing by a mobile telephone company. The first domestic equity listing (a domestic brewery, BRALIRWA) is expected to take place in mid-2010. CMAC has also proposed to the Government that the market should be strengthened by listing State-owned enterprises as part of the privatization process. As part of CMAC’s market promotion strategy, listing fees have been set at low levels (in contrast to some other EAC exchanges) – for example, listing an equity security requires an initial fee of between RWF 1 and 20 million (i.e. a minimum of less than USUS$2,000) depending on the size of the listing, with annual fees in the RWF 1 to 10 million. Similar fee scales apply to debt security listings.

CMAC is also focused on taking advantage of the opportunities presented to promote foreign direct investment (which is a key pillar of national development strategy) by integration with other EAC capital markets. Its strategy focuses on: membership and active participation in regional bodies\textsuperscript{57}; and, selecting a trading and settlement platform which is compatible with those used in Kenya, Tanzania, and Uganda and CMAC is an active proponent of forming a regional market (something supported by Kenya – a potential capital exporter - but less so by Uganda and Tanzania).

(vi) Insurance Sector Snapshot

The Rwanda insurance market is small, with total premium income of about 1 percent of GDP\textsuperscript{58} (no official data on consolidated operations of the sector are accessible), which compares to an average of about 1.5 percent for the EAC as a whole and is approximately equal to the ratio of premium income to GDP in Burundi (see Table 3.5). There are a total of five commercial insurance companies, one of which is a pure medical insurer; three State-operated social insurers; and, six insurance brokers. There are no reinsurers, and as a consequence Rwandan firms reinsure abroad, primarily in Kenya but also directly with European firms (although one

\textsuperscript{56} “CIS [collective investment schemes] contribute a very significant proportion in the development and deepening of the capital market because without a collective investment scheme every investor would invest directly in the market. We needed the law to make sure that investment managers handling the money has the right qualification and that they have to disclose their investment strategies and policies to the public.” Robert Mathu, Executive Director, CMAC, interviewed in East Africa Business Week, January 2010.

\textsuperscript{57} CMAC is a member of the East African Securities Regulatory Association and East African Stock Exchanges Association.

\textsuperscript{58} Source: BOR Governor quoted in \textit{New Times}, June 2009.
Rwandan firm stated that doing so is more a matter of prestige than necessity). The sector’s lack of capacity is further highlighted by the lack of actuaries, qualified claims adjusters and risk assessors.

The sector is dominated by one firm (SONARWA) which is believed to control approximately 75 percent of the market (excluding premiums paid to social insurers). Products available on the market are life and auto insurance (including COMESA “Yellow Card” international insurance). SONARWA (which may be taken as a proxy for the sector, given its size) indicated that premiums are presently split almost evenly between life and auto coverage, but that – unusually for Sub-Saharan Africa – the life business is growing very rapidly. SONARWA also stated that it is starting to explore expansion cross-border into other EAC countries, with Burundi and Tanzania being possible initial targets and, also, potentially seeking additional capital from other EAC insurance companies to increase the firm’s underwriting capacity to respond to foreign competition.

(vii) Insurance Supervision & Regulation

The insurance sector is de jure regulated by the National Insurance Commission (NIC) established by the Insurance Law of 2002. However, the NIC has not started to operate and regulation and supervision are presently carried out by the BOR. The BOR has identified the operationalization of the NIC and introduction of a new Insurance Act as priorities for the development of the sector. In 2009 consultants were working to draft a new Insurance Contracts Law and a Mandatory Insurance Law (to provide casualty coverage for workers in hazardous occupations). In contrast to other EAC countries, insurance companies are now permitted to invest in all kinds of securities, including foreign securities. Insurance firms described the lack of a cross-border regulatory framework as an obstacle to taking advantage of EAC membership by preventing them from selling insurance outside Rwanda. However, one insurance firm also claimed that one or more Kenyan firms are already selling casualty insurance in Rwanda, and as noted above, Burundian firms reported that Rwandan insurers have been selling casualty cover in Burundi (this was confirmed by the Burundian firm involved). Both these reports indicate that the insurance market is developing cross-border despite - or possibly because of - the lack of regulation.

(viii) Payments System

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59 This is also permitted in Uganda, but insurers and pension funds described strong moral suasion and procedural obstacles to investing abroad (see comments on this issue in FSITR).

60 “The law is clear and no company, local or foreign, is supposed to place its insurance outside the country. But over 90% of the foreign companies especially the multi-laterals or those with foreign shareholding, have continued to violate the law.” Corneille Karekezi, Deputy Director General of SONARWA quoted in New Times, 13 July 2006.
Rwanda is in the process of procuring an automated payments system. The BOR (the responsible institution) has focused the design of the system on compatibility with other EAC systems and, as discussed above, this system is needed to support both banking system and capital market expansion. Ultimately, connection to a regional switch should be a priority in order to facilitate the development of intra-EAC trade, but agreement has yet to be reached within the EAC on establishing the switch.

In interviews, banks voiced strong complaints regarding the inadequacy of the current settlement system and, specifically, the restrictions placed on ATM expansion by requirements to use the BOR’s existing system. Foreign banks noted that the current system is an obstacle to timely intra-EAC settlement, with most international payments still having to be routed through correspondents in Europe, imposing significant (approximately 1.5 to 2 percent of the payment amount) transaction costs on customers and causing major delays. Only one bank indicated that it could execute a direct intra-EAC transfer, and then only to Kenya.

**D. Recommendations**

(i) Introduction

The integration of Burundi and Rwanda into the EAC’s financial system brings the problems posed by small scale into sharp relief. Of the two countries, the awareness of the need to achieve scale to support high quality regulation and supervision, to support capital markets development, and to build physical infrastructure such as payments and settlement systems, is clearly most advanced in Rwanda. Burundi still lacks a coherent vision of how its financial system will be integrated with the EAC and as a consequence needs to do much work to formulate a strategic vision and move forward with implementing its strategy. The alternative is to see the direction and development of the financial system largely passed to institutions in other EAC countries. Opportunities to create – and benefit from - scale arise from the two countries’ similar legal systems (although they are increasingly divergent due to the faster pace of Rwanda’s reforms), similar positions astride trade routes into Central Africa, and shortages of capacity.

The recommendations below reflect to some extent the unusual nature of the EAC accession process. Unlike communities such as the European Union, the EAC has worked on a post-membership convergence principle, with countries joining and then seeking to harmonize their laws and regulations for the financial sector with other member states. One consequence of this approach is that parts of the financial sector may be exposed to cross-border activity and
competition before the regulatory and supervisory frameworks are in prepared (as in the Rwanda and Burundi insurance sectors), another is that financial institutions may enter from larger markets with a degree of sophistication greater than the host regulator’s, posing a risk that supervision will be inadequate. As a result, countries – such as Burundi and Rwanda – may be called upon to build capacity on a “crash basis”. These circumstances in turn may require a greater willingness to seek capacity-building solutions which may require some willingness to surrender a degree of sovereignty in order to gain the benefits of scale: as discussed above, both Burundi and Rwanda could benefit from forming joint regulatory institutions.

(ii) Recommendations

It is expected that the recommendations below would be utilized in the identification of technical assistance and other support for integration in the proposed World Bank and donors EAC Regional Financial Market Integration project.

(a) Develop an EAC Integration Strategy for the Burundi Financial Sector

Burundi needs assistance in developing a coherent strategy for integrating the financial sector with the EAC. This assistance should focus on:

- Assessment of the financing needs of the real sector, including manufacturing, housing, agriculture, and trans-shipment trade.

- Assessment of the capacity the financial sector as presently constituted to meet financing needs. Identification of capital shortfalls and financial products needed.

- Assessment of Burundi’s banking and insurance laws and regulations harmonization with other EAC countries.

- Supervisory capacity assessment, including identification of critical skills and equipment shortages.

- Definition of Government strategy towards inward investment in the financial sector and an associated licensing policy for foreign entrants.

- Definition of Government’s policy towards joint regulation and supervision of parts of the financial sector with Rwanda. Serious consideration could be given to joint supervision of the insurance sector (where both countries lack a functioning independent insurance supervisor) and for the banking sector (where both countries
lack regulatory scale and the EAC’s intention to form a single EAC-wide supervisory institution is already agreed between the members).

- Preparation of short and medium term supervisory action plans for both the banking and insurance regulators. These plans should reflect the definition of the Government’s policy towards joint Burundi/Rwanda regulatory institutions.

(b) Support to Accelerate Burundi’s Convergence with EAC Financial Sector Laws

Given the work already done in Rwanda to prepare an EAC convergent laws and regulations for the financial sector, it would make sense – given the common legal heritage of the two countries – for Burundi to use these laws (on banking, payments, collective investment schemes, and capital markets functions) as models for its own reforms. Technical assistance could therefore be provided to draft new laws and regulations for Burundi using the Rwandan models.

(c) Financing for Supervisory Development

For both Burundi and Rwanda flexible technical assistance credits could be created to deliver capacity building support on a flexible basis, using a framework contract (in Burundi’s case, this could build on a current FIRST project\textsuperscript{61}). This would allow the regulators in both countries – over a period of three to four years – to draw technical assistance and finance equipment and software on an ad hoc basis.

(d) Financing for Burundi’s Payments System

As discussed above, the Burundi authorities see the logic of purchasing a payments system which is fully compatible with that procured by Rwanda. A substantial cost has already been absorbed by the Rwandan authorities in preparing the specifications for a new system, and financial support could be given to Burundi to “piggyback” on the Rwandan procurement. This might also enable the Rwandan procurement to reduce costs by increasing the total size of the hardware, software and services contract(s) by the addition of duplicated systems for Burundi\textsuperscript{62}.

\textsuperscript{61} Burundi: Financial Sector Strategy, approved October 2009.

\textsuperscript{62} Guinea, Liberia, and Sierra Leone are taking this approach by purchasing uniform payments systems (which can also later be easily connected) under a projected sponsored by the West African Monetary Institute and financed by the African Development Bank.
Appendix 1: Commodity Trade in the EAC

Source: IMF, Direction of Trade Database, August 2009
Appendix 2: Bank Survey

As part of the fieldwork we interviewed most of the leading banks in East Africa. Most of the multinational banks have subsidiaries in all the original EAC countries (Kenya, Uganda & Tanzania). Some local banks (particularly from Kenya) have branched out of their region and have branches in one or several countries including Rwanda and Burundi. Nevertheless, the Rwandan and Burundi banking systems are quite small and not nearly as well integrated regionally as those of the original partner states. The interviews were followed by a brief survey that followed up on several issues that came up in the interviews. The response rate to the surveys was over 50 percent but a more serious concern was that not all the respondents answered all the questions.

**Questionnaire on Cross-Border Banking**

This questionnaire is intended to gauge the extent and nature of cross-border banking in the East African Community. Please be assured that all responses will be kept confidential and we will not ascribe any information to any single institution or individual. Please fill in the necessary information and return via email. Thank you for your cooperation.

**Section 1. Basic Institutional information**

1.1 Name of institution:


1.2a Name of respondent:


1.2b Email and telephone number of respondent:
1.3a Where are your corporate headquarters located?

- [ ] East Africa (name country)
- [ ] Outside Africa (name country)

1.3b Where (if anywhere) in East Africa are your country offices/subsidiaries located?

- [ ] Burundi
- [ ] Kenya
- [ ] Rwanda
- [ ] Tanzania
- [ ] Uganda

Section 2. Operational Integration

2.1a Are your operations in the East African region hubbed?

- [ ] Yes
- [ ] No

2.1b If yes, where is the organization’s operational hub?

2.2a Indicate how integrated your East Africa operations are on a scale of 0(no
<table>
<thead>
<tr>
<th><strong>integration</strong> to 5(full integration)</th>
</tr>
</thead>
<tbody>
<tr>
<td>□ 0</td>
</tr>
</tbody>
</table>

2.2b If checked 1 through 4 above briefly describe partial integration

<table>
<thead>
<tr>
<th><strong>2.3 Are common process flows used within the East African region?</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>□ IT platform □ Accounting systems □ Human resources</td>
</tr>
<tr>
<td>□ Credit approval and control □ Asset/liability management</td>
</tr>
<tr>
<td>□ Other (describe briefly)</td>
</tr>
</tbody>
</table>

2.4 Is there a group standard for the East African region or Africa?

| □ Yes | □ No |

2.5 Do clients from one country need a separate application process to open account in another East African country?

| □ Yes | □ No |

2.6 Indicate the extent to which foreign exchange controls and/or capital account restrictions hamper you in serving your clients on a regional basis
**2.7a** Has your presence in more than one EAC country enabled you to achieve the operational scale required to introduce financial products which would not be viable in one country alone?

- [ ] Yes
- [ ] No

If yes, which products?

**2.8a** Indicate the extent to which differences in regulations prevent you from introducing mass market (retail/SME) credit products which require scale to be viable? 0(low) to 5(high)

- [ ] 0
- [ ] 1
- [ ] 2
- [ ] 3
- [ ] 4
- [ ] 5

If yes, what type of products?

**2.9** Indicate how important single licensing would be to further integration 0(low) to 5(high)

- [ ] 0
- [ ] 1
- [ ] 2
- [ ] 3
- [ ] 4
- [ ] 5
2.10 Describe briefly the *single most* significant barrier to further operational integration

Section 3. Trade between Country offices/Subsidiaries

3.1 How many Nostro Accounts do you maintain in East Africa?

3.2 Which country’s Nostro Accounts have the highest volume of transaction?

   i.    ii.    iii.    iv.    v.

3.3 What types of transaction have the highest volumes?

   - inter-bank trade
   - trade accounts
   - carry trade
   - loan payments
   - investment accounts
   - education transactions
   - other (specify)

3.4 What is the volume of trade within your Nostro Accounts in the East African Region?

<table>
<thead>
<tr>
<th>Volume of Transaction</th>
<th>Average Size of Transaction</th>
<th>Most Common Type of Transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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</tbody>
</table>
### Section 4. Central Bank Supervision

**4.1 Has your hub operation had supervision from a Central Bank in another country in the region?**

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kenya</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tanzania</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Uganda</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rwanda</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Burundi</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**4.2 Describe the nature of this supervision**

<table>
<thead>
<tr>
<th></th>
<th>Normal routine inspection</th>
<th>Special inspection</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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</table>

**4.3a If routine inspection, how many times a year is your hub operation inspected?**

<p>| |</p>
<table>
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</tbody>
</table>

**4.3b If routine inspection, do you file compliance reports to this Central Bank?**

<p>| |</p>
<table>
<thead>
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</thead>
<tbody>
<tr>
<td></td>
</tr>
</tbody>
</table>
4.3c  If yes, has this had a negative impact on your business operations?

| ☐ Yes | ☐ No |

4.3d  If yes, describe briefly

|   |

4.4  If special inspection, please describe

|   |

4.5  Provide an estimate of the additional costs (if any) in labor hours per year to your bank of differences in regulatory reporting requirements between different EAC countries?

|   |

Thank you. Your time is much appreciated.
A brief description of some of the institutions interviewed and surveyed is provided below.

**Standard Chartered Bank Kenya**

Standard Chartered Bank opened its doors in Kenya in January 1911, with two branches. Today, the bank has an excellent franchise with a network of 32 branches countrywide, with its regional headquarters located in Nairobi. The bank is a Public Ltd company quoted at the Nairobi Stock Exchange (NSE) with 25% local shareholding. The bank serves wholesale, SME and personal customers by providing a wide range of services through its wholesale, SME & personal banking divisions. Services provided by the bank include; personal banking, SME banking, Wholesale banking, Deposits, Loans, E-banking and wealth management services.

**Diamond Trust Bank Kenya**

Diamond Trust Bank (DTB) Kenya was incorporated in 1946 as the Diamond Jubilee Investment Trust. Over the years the bank has transformed itself from a community based organization into a non bank financial institution and eventually into a fully fledged commercial bank (July 1997). The bank has subsidiaries in Tanzania, Uganda and Burundi. Presently, DTB Kenya operates as a medium size commercial bank, offering banking product and services to small and medium size customers, including corporates, SMEs and the consumer banking customers. The bank also offers money transfer services to the unbanked community in Kenya under an arrangement with western union.

**Kenya Commercial Bank Tanzania**

KCB (Tanzania) Limited was incorporated in April 1997 as a subsidiary of the KCB group, a financial services provider domiciled in Kenya. It was established to provide a wide range of financial products to the emerging economies of this region and to facilitate cross border trade following the revival of the East African Co-operation.

**Stanbic Bank Tanzania**

Stanbic Bank (Tanzania) came into being in May 1995 when the operations of Meridien Biao Bank Tanzania Ltd were acquired by the Standard Bank Group, based in South Africa. The bank has 8 branches and offers a wide range of financial products and services to personal, business, corporate and investment customers.
Kenya Commercial Bank Uganda

KCB Uganda Ltd was incorporated in the year 2007 as a subsidiary of the KCB group, a financial services provider domiciled in Kenya. The bank has 7 branches and plans to embark on an expansion strategy which will see it increase its branch network by six branches over the next one year. The bank is now offering fully fledged universal banking products that are tailored for the Ugandan market which includes world class infrastructure capable of facilitating one-branch banking in a cross border business environment. Some of the banking services offered includes SME banking, Corporate banking, Personal banking, money transfers and mortgage products.

Stanbic Uganda

Stanbic Uganda is part of one of Africa’s leading banking and financial services group, Standard Bank. The bank was founded in Uganda as the National Bank of India in 1906, which after several name changes became Grindlays Bank. When the Standard Bank Group bought the Grindlays’ network in Africa, it also, in October 1993, re-established a connection with Uganda. The bank is licenced as a merchant banker, stockbroker and financial adviser. It offers a wide range of financial products and services to personal, business, corporate and investment customers.

Citibank

Citibank Kenya is a branch of Citibank NA, New York. The bank has two branches and is the head of the Citibank East Africa organization, which covers branches in Kenya, Tanzania, Uganda and Zambia. The bank is structured around business segments, product groups, operations and technology and staff units. The business segments include; corporate bank responsible for global relationship banking and top-tier local corporate clients and financial institutions group that is responsible for business with banks, insurance companies and other non-bank financial institutions. The organization seeks to encourage entrepreneurship and management initiative, move day to day decision making closer to customers and market place, and create an environment where improvements generated in one business will spread quickly to the rest.

Fina Bank Kenya

Fina Bank was originally incorporated as a non banking financial institution (NBFI) in 1986. In 1995, the banking laws in Kenya were changed and NBFI's were required to convert into fully
fledged commercial bank or close down, the then NBFI seized the opportunity and in 1996 Fina Bank Ltd was born. It immediately started to provide full banking services. The company is now shifting from being a small respected financial institution largely serving one community, to a focused medium sized commercial bank with a strong developmental emphasis especially in the rural areas. It aims to serve the entire SME sector of Kenya and the East African region. This sector is currently under banked and therefore presents an excellent opportunity for growth.

**Equity Bank Ltd**

Having commenced business in 1984, Equity bank has evolved from a building society to a microfinance institution and now the all inclusive NSE public listed commercial bank. The bank has received both local and global accolades for its unique and transformational financial model. The bank is credited for taking banking services to the people through its accessible, affordable and flexible service provision. The bank offers financial services including personal banking, business banking, corporate banking, e-banking and cash back services.