CGAP

Uganda

POLICY, REGULATORY, AND SUPERVISORY COVID-19 RESPONSES FOR MICROFINANCE

CGAP BACKGROUND DOCUMENT

JUNE 2020

This note is part of a series of CGAP background documents that examine the impact of the COVID-19 crisis on microfinance at the country level and focus on policy and regulatory responses adopted by financial authorities in each country. The notes are based on interviews and review of publicly available materials, and, in some cases, with written input from key stakeholders in the microfinance sector. Coverage is from the onset of the crisis through mid-June, although the situation continues to evolve.

Country context and COVID-19 containment measures

Having successfully fought the Ebola virus in its northern region in the early 2000s, Uganda took early and swift measures to contain the spread of COVID-19. The first case of contagion was officially registered on 22 March 2020. The country immediately closed its borders. On 25 March, public and private transport was halted and a total lockdown was declared. Aggressive law enforcement measures were put in place. COVID-19 has been contained so far, and no deaths have been reported. On 6 May, many businesses were allowed to reopen but people's movements were still largely restricted, including through a night-time curfew.

Uganda's economy was relatively strong before COVID-19. Significant government spending and inflation were within the target set by the Bank of Uganda (BOU). However, GDP growth had fallen from 6.3 percent in 2018 to 4.9 percent in 2019. In addition, the country was already facing challenges posed by heavy rains and the ongoing locust invasion when the COVID-19 outbreak began. Post-COVID-19 growth is expected to decline to 3–4 percent. On 6 May, just as many business began to reopen, the International Monetary Fund (IMF) approved US$491 million in emergency assistance to Uganda.

As has been the case in most of the world, the lockdown in Uganda is disrupting the lives of poor people, including farmers—48 percent of all adults rely on farming income while only 3 percent are employed in the formal sector. Border and market closures also have cut off supply chains. Many micro and small entrepreneurs (MSEs) are starting to use business capital to meet their most basic needs, but eroding capital could make their rebound from the crisis more difficult. Microfinance providers (MFPs) estimate that many of their clients may go out of business.[1]

One million people are believed to have been laid off, and borrowers are requesting debt and rent relief. Recent FSD Uganda surveys show that 75 percent of Ugandan adults were struggling financially even before COVID-19 hit. Most have very little room to cope with reduced income, and borrowing is the main coping mechanism for 42 percent of adults. The Ministry of Finance, Planning and Economic Development estimates that 2.6 million Ugandans will be pushed into poverty.

The microfinance sector

According to Finscope, most of the 18.6 million Ugandan adults (16+ years of age) use informal financial services—mainly village savings and loan associations (VSLAs) and rotating savings and credit associations (ROSCAs). However, 58 percent of them have taken up formal financial services driven by mobile money. One of every three savers keeps their savings at home, and only 49 percent of borrowers borrow from formal lenders (most use family/friends and VSLAs). Only 11 percent of those who save do it with commercial banks. Forty-eight percent of all adults in rural areas (rural adults represent 76 percent of all

[1] We use the term "microfinance provider" to refer to a wider range of providers than those associated with the term "microfinance institution."

adults) use informal services only. According to Findex, 59.2 percent of adults (15+ years of age) own an account at a financial institution.

Although exact numbers are not available, MFPs—some of which are commercial banks—may serve more Ugandans than the rest of the regulated financial sector. Regulated MFPs are divided into tiers defined in legislation, as shown in Table 1. Institutions in all tiers provide microfinance. As a rule, Tiers 1 through 3 are regulated by BOU while Tier 4 is regulated by the Uganda Microfinance Regulatory Authority (UMRA). An exception to the rule is that large savings and credit cooperative organizations (SACCOs), which are under BOU, are part of Tier 4.

Table 1. BOU-regulated MFPs	
Deposit-taking MFPs	
Commercial banks	**Tier 1** (commercial bank) Financial Institutions Act, 2004, and 2016 amendment • The main player is Centenary Bank, one of the largest among 26 licensed commercial banks. It has 1.4 million depositors. Triodos is a shareholder/lender. • Finance Trust Bank is a former Tier 3 institution (which started as an NGO in 1984), operating mostly in rural areas. Shareholders include Oikocredit and Progression Eastern African Microfinance Equity Fund. Over 470,000 clients. • Opportunity Bank Uganda Ltd was founded in 1995 as a microcredit program of Food for the Hungry International and is now owned mostly by MyBucks (a fintech listed in Frankfurt) and Opportunity International. It offers a range of microlending and savings products, in addition to agent banking, mobile banking, and links to mobile money accounts. It only recently has upgraded from Tier 2. • Equity Bank Uganda is a subsidiary of the Kenyan group, having started operations in Uganda in 2008 through the acquisition of Uganda Microfinance Ltd, a former Tier 3 microfinance deposit-taking institution (MDI). Equity Bank has implemented several digital means to interact with customers, including internet banking, mobile banking, mobile money, ATMs, and mobile branches. It offers microloans (including digital microloans) and others, payment services, and remittances.
Specialized microfinance banks	**Tier 2** (credit institution) Financial Institutions Act, 2004, and 2016 amendment: • BRAC Uganda Bank Ltd started deposit-taking as a Tier 2 institution in 2019 and already has 294,000 deposit accounts, with total deposits growing. It has around 200,000 borrowers and US$73 million in loans. It was incorporated in Uganda in 2017 as BRAC Uganda Finance Ltd., before obtaining a credit institution license. • Post Bank Uganda is a government-owned credit institution. It is a major provider of agricultural loans. It also offers group, solar, school, salary, and MFI/SACCO loans, among others, and savings, payments services, and accounts for VSLAs. It has an extensive network that includes some partner SACCOs.
DTMFP (deposit-taking MFPs)	**Tier 3** (MDIs) Micro Finance Deposit Taking Institutions Act, 2003. The five MDIs are: • **Pride.** Owned by the Government of Uganda. Pride Uganda was founded in 1995 by the Government of Uganda and the Norwegian

	Agency for Development Corporation. In 2004 Pride Microfinance Ltd. (PML) took over the assets and liabilities of Pride Uganda. PML has over half a million clients of micro, small, medium and upscale entrepreneurs in rural and urban areas. • **Finca.** Owned by FINCA Microfinance Coöperatief UA (the Netherlands). • **EFC Uganda Ltd.** Several domestic, regional, and international investors such as the Belgium Investment Company for Developing Countries and Développement International Desjardins. It was incorporated in 2011 as a company limited by shares and operated as a money-lending business before obtaining an MDI license from BOU in 2014. • **UGAFODE.** Started as an NGO in 1994. It has an important portfolio of agricultural loans. It also offers other loan types, savings, and digital payments and remittances. It was incorporated as a company limited by shares in 2010 to take over the microfinance activities of the original NGO, Uganda Agency for Development Ltd, and obtained its MDI license from BOU in 2011. • **Yako.** Started operating in Uganda in 2010 and was granted an MDI license in 2015.
SACCOs	SACCOs are primarily governed by the Cooperative Societies Act (amended in 2019). They can serve only members. According to the Tier 4 Microfinance Institutions and Moneylenders Act, which passed in 2016 and changed MDIA, large SACCOs (those with member voluntary savings in excess of USh 1.5 billion [US$400,000] and institutional capital above USh 500 million [US$133,000]) shall apply for a license from BOU. The regulations for the large SACCOs (registered societies) have not yet been issued.
MFPs regulated by Uganda Microfinance Regulatory Authority (UMRA)	
Tier 4 institutions (Tier 4 Microfinance Institutions and Moneylenders Act, 2016)	
Deposit-taking co-ops	• SACCOs. The total number of SACCOs is not known but UMRA estimates could range from 2,000 to 6,000 (including "dormant" SACCOs). UMRA has already licensed over 200 of them.

Nondeposit-taking NBFIs	• Nondeposit-taking microfinance institutions (NDMFIs). These are either companies or NGOs and the total number of them is not known. In 2018, UMRA issued regulations for NDMFIs and for moneylenders. UMRA already has licensed 250 institutions. The main ones include:
	  • ASA International, a global network that also is active in other East African countries. Began operating in Uganda in 2013. Reported "high-pace growth" in 2019, with 87,000 clients, 83 branches, and PAR30 of 0.1 percent. It expects PAR30 to rise from 5 percent to 10 percent.
	  • Vision Fund, part of the global network.
	  • Several leasing companies have an MFI license, including Fenix International, SafeBoda, and Tugende. Some digital lenders like Numida also have an MFI license.
	• Other Tier 4 institutions regulated under the law include moneylenders (800 hundred of which have already been licensed by UMRA) and self-help groups, which include VSLAs.

Tiers 1, 2, and 3 together serve about 8.5 million customers. The number of borrowers and depositors served by Tier 4 is not known and the number of depositors of SACCOs is also not available. Across all MFPs, a range of services are offered: savings, consumer loans,

agricultural loans, asset finance, solar loans, group loans, payments, and remittances. While Tier 4 MFIs are not allowed to take deposits from the public, they may collect "compulsory savings" as collateral for loans. MDIs also have what is considered in practice "non-microfinance" operations, such as larger loans and deposits (according to MDIA, all loans are limited to 1 percent and 5 percent of the MDI's core capital, for individual loans and group loans, respectively).

Most MFPs, including Centenary, Finance Trust, BRAC, Finca, Pride, and several SACCOs, are members of the Association of Microfinance Institutions of Uganda (AMFIU). There also is the Uganda Cooperative and Savings Credit Union and the Uganda Moneylenders Association. None of them publishes updated financial or statistical data about the sector, including on performance indicators such as portfolio quality. Interviews with experts on the Ugandan microfinance sector suggest that MDIs and banks were growing consistently and had low NPLs before the COVID-19 crisis. Among Tier 4 institutions, MFIs and moneylenders may be better managed than SACCOs, which often have weak governance and management information systems. Tier 4 institutions do not report to or have access to the credit reference bureau, which is managed by BOU for the exclusive use by institutions in Tiers 1–3. Overall, BOU-regulated MFPs are considered better managed.

The pandemic's impact on MFPs

With the COVID-19 outbreak and subsequent lockdown, many MFPs have declared payment holidays for their borrowers, stopping collection of principal and/or interest. AMFIU reported a decline in its members' average repayment rate from 82 percent in January to 41 percent in April. The Microfinance Support Center reported a decline of 72 percent and 81 percent in savings and repayments at the SACCOs and VSLAs, respectively, it funds.

ASA International reports that its affiliate in Uganda has implemented a policy to consider the lockdown to be a payment holiday, during which only interest will accrue on the outstanding balance, if a borrower does not repay the loan installments. Staff are working from home, have lost their jobs, or are on unpaid leave. Group meetings have been halted. Many SACCOs have not been able to conduct their annual general meetings to, among other things, approve the extension of the terms of executive committee members, which may create governance risks.

By the end of April, four out of the five MDIs had implemented borrower relief measures such as moratoria for a short period (1–3 months) and other restructuring, including for larger loans. Group loans are affected the most because of the restrictions imposed on people's movements, which make it difficult for MFPs to organize group meetings. Loan collection by one MDI had, by the end of April, gone down by 30 percent. There are no available data on the current level of NPLs by type of loan (e.g., microfinance loans versus larger loans), but the regulators believe that agricultural loans have been the least affected while loans to microentrepreneurs in the cities were more affected. The portfolios of some MFPs already may have hit very high levels of PAR30. However, according to BOU, the average MDI NPL was at 3.5 percent at the end of April.

The virus containment measures and the inherent vulnerability of MFP clients who rely on variable income streams are expected to further increase NPLs and provisions at MFPs. NPLs among institutions in Tiers 1–3 are expected to rise from 4.7 percent to 5.9 percent, particularly loans to transport, tourism, trade, and construction, which amount to 45 percent of total banking loans to the private sector. There are no official estimates for Tier 4 institutions, but industry experts believe NPLs and PAR30 may double. The full impact on the industry is unknown.

Profitability and ability to comply with minimum regulatory capital and liquidity ratios (where applicable) are expected to be seriously impacted. Many SACCOs could become insolvent, partly due to precrisis weaknesses. In addition, there are reports that SACCO members are withdrawing their savings. Elsewhere, deposits seem to be stable, with no signs of panic, although some MFPs that were unable to operate due to a halt in public transport had to convince depositors that closure was not due to failure.

MFPs under BOU are conducting frequent—daily or weekly—stress tests based on scenarios such as an extended lockdown and their potential impact on loan repayment and liquidity position. Some MFPs have enough liquidity to continue paying their staff and other expenses for several months, but others may quickly run dry.

There is no information available on whether Tier 4 entities are conducting stress testing. Our conversations with industry representatives, experts and the regulators indicate that major MFPs have been (or are expected to be) able to renegotiate debt terms with creditors, although some are under pressure in this regard. AMFIU reportedly has held meetings with MFP wholesale lenders to negotiate loan restructuring. Regarding MDIs specifically, NPL, liquidity, and solvency indicators at the industry level at the end of April were not raising red flags, according to BOU.

MFPs that had adopted digital channels before the crisis are believed to be coping better than their peers. They can collect loans from those who are able to repay, allow savings and withdrawals, and earn fees from digital payments.[2]

However, most MFP clients have no access to microfinance services during the lockdown because of the low levels of digitization and weak links to mobile money services. Without digital means to provide services, some MFPs have seen their operational costs increase. Some MFP buy airtime for clients to keep in touch through SMS, while others have hired private transportation, and most bought personal protection equipment for the few staff at branches. Major MFPs under BOU are keeping in constant touch with clients, by phone and SMS, to assess their financial situation and ensure high repayment rates when the economy restarts.

Despite the challenges, there is still optimism based on the resilience of low-income clients and the microfinance sector as a whole. If the lockdown is not extended for too long, MFPs believe many of their clients will quickly rebound, and the demand for loans will be strong in the aftermath. MPFs will need sufficient liquidity to prompt their clients out of the crisis and to refinance existing loans.

Policy, regulatory, and supervisory measures affecting regulated MFPs

Enable continued, safe operations by MFPs

Having been declared essential services, MFPs in Uganda are allowed to continue operating, despite practical difficulties faced by those MFPs that have a high-touch client engagement model (e.g., group methodology). UMRA specifically directed Tier 4 entities to follow the health advisory guidelines from government and to keep the authority up to date on emerging issues affecting MFP operations. It also advised Tier 4 MFIs to suspend physical contact such as client mobilization and loan recoveries. BOU issued guidance on flexible operating hours. It encouraged banks and mobile money services providers to reduce fees and increase daily transaction and account balance limits for mobile money and other digital payments.

[2] The leading mobile money provider, MTN Money, has waved transaction fees; some banks, including Centenary, have also waived some fees.

Relief for MFP clients

After the Monetary Policy Statement of 6 April, BOU issued a Guideline and a Circular on the treatment of borrowers affected by the COVID-19 crisis, which are applicable to all institutions in Tiers 1–3.

Exceptional permission for loan restructuring:

- Restructuring must happen between 1 April 2020 and 31 March 2021.
- Repayment holidays, moratoria (suspension, postponement, or reduction of principal amounts, interest, or full payments for up to 12 months), loan tenor extensions, or other restructuring covered in regulations are permitted.
- Valid for corporate/individuals impacted by the pandemic, on a case-by-case basis.
- Valid for facilities granted on or before 1 April 2020 and not classified as loss as of 31 March 2020.

Prudential treatment of restructuring:

- The moratorium period is excluded from counting of days past due.
- The credit status at the time of granting the relief remains unchanged for the duration of the moratorium, with no change in loan loss provisioning, unless the borrower becomes delinquent after the moratorium/restructuring.
- The restructuring shall not be reported to the credit reference bureau as a negative event.
- Moratoria suspend reporting to the credit reference bureau.
- Interest can be accrued (although the MFPs who choose to are allowed to not accrue interest for the benefit of their customers).
- No prepayment of arrears as a condition for restructuring**.** Unpaid arrears may be capitalized as part of the restructuring, less associated penal interests and fees.
- Lenders shall assess the repayment capacity of the borrower following their policies.
- Write-off extended by 180 days for loans classified as loss at 31 March 2020, if the original write-off date falls due between 1 April 2020 and 31 March 2021.

Consumer advice and protection:

- Clarification that credit relief does not eliminate the debtor's obligation.
- Clarification that the decision to provide or decline relief is the responsibility of the lender, but borrowers are encouraged to request relief.
- Relief must be in the interest of consumers and with full disclosure and no hidden charges. Borrowers must consent to relief granted.
- Recovery of accrued interest shall be in such a manner that the expected periodic repayments do not exceed those the borrower had contracted before the moratorium.
- Two restructurings in the 12-month period are permitted for each credit, although BOU may permit more.

According to BOU, most MFPs have offered their clients a one- to three-month moratorium. BOU has been encouraging MFPs to continue lending (but has warned lenders that any new lending is subject to precrisis prudential treatment) and has clarified the applicable special provisioning, classification, and credit reporting rules. No prudential standards (e.g., capital adequacy, provisioning schedule, or definition of NPL) have been changed, although the standard period for writing off loans classified as loss has been extended from 90 to 180 days. BOU is working on guidelines for public disclosure of the special relief measures in the financial statements of institutions in Tiers 1–3.

UMRA announced similar but less detailed relief measures through its Guidelines of 20 April (applicable only to MFIs and moneylenders) on credit management and loan restructuring during COVID-19, which will be in force for up to 12 months starting 1 April 2020. The Guidelines focus on loan moratoria. While Tier 4 institutions have not been mandated to provide a moratorium to borrowers that have been affected by the pandemic, the Guidelines state: "clients may request a restructuring if they qualify" and "all institutions with intention to provide credit relief and restructuring must have in place an approved policy." In practice, many Tier 4 entities have offered a moratorium. UMRA has clarified the following aspects:

- Interest accrued during the moratorium can be capitalized and amortized during the restructured loan period but cannot exceed the original interest rate.
- Any fees on restructuring during the pandemic must be reasonable and justifiable.
- MFPs must assess the borrower's repayment capacity.
- Restructuring must not be treated as an adverse change in credit risk profile of the client.
- Consumer protection guidelines must be observed.

In a separate advisory note, UMRA has encouraged its licensees to continue to collect repayments from customers who want to repay based on their original loan schedule.

Liquidity to MFPs

BOU has been swift in offering liquidity support to Tier 1–3 institutions:

- Exceptional liquidity assistance to Tier 1 banks in distress for up to one year.
- Reverse repo of up to 60 days at Central Bank Rate, which can be rolled over.
- Purchase of treasury bonds held by institutions in Tiers 2 and 3. For those that do not have enough treasury bonds to serve as collateral, BOU support may be extended based on the MFP's holdings of unencumbered fixed deposits placed with other BOU-regulated institutions. (As of the end of May, no Tier 2 or 3 institution had required this support by BOU).
- CBR lowered by 2 percentage points to 7 percent.
- Institutions must defer discretionary distributions (dividend, bonus) for at least 90 days from March 2020.
- The loan write-off rules were not altered (currently, a loan must be written off when classified as loss for more than 270 days).

UMRA has encouraged its licensees to seek relief from their bank lenders, but no specific relief package has been created. Tier 4 MFIs do not have access to BOU facilities, but many, including several SACCOs, borrow from banks.

The government has been discussing other support measures, such as a financing line through the Uganda Development Bank; however, implementation challenges are expected. Tax relief also has been discussed, but not implemented.

Reduce regulatory/supervisory burden on MFPs

BOU is reportedly closely engaging with its regulated entities to monitor the situation and discuss additional measures. Tier 1–3 institutions are required to report monthly to BOU about their measures to respond to the crisis and the changing risk profile of their loan portfolios. BOU is receiving weekly reporting on their liquidity position and has instructed banks to keep in touch with borrowers during the pandemic. Institutions in Tiers 2 and 3 also are being closely monitored weekly by BOU regarding liquidity. BOU has not announced any

specific supervisory relief, such as postponement of noncritical activities, deadlines, and reporting (although no onsite activities are being carried out). In fact, it has imposed additional requirements on institutions in Tiers 1–3, specifically the design and reporting of a policy for the application of relief measures and of liquidity contingency plans. After the pandemic is contained, BOU onsite teams will be looking at these issues.

UMRA has encouraged Tier 4 institutions to actively engage with UMRA on operational challenges and to openly discuss liquidity positions, portfolio quality, productivity, and delinquency positions and to get specialized advice from the authority. However, UMRA has only recently been created, and the Tier 4 sector has a long history of operating unregulated. Hence, supervision and supervisory data collection are still at early stages.