Speaking notes

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Informal Dinner for the Uganda Bankers' Association

Golden Tulip Canaan Kampala Hotel

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The Chairperson Uganda Bankers' Association
Chief Executive Officers of Financial Institutions
The Executive Director Uganda Bankers Association
Colleagues from Bank of Uganda
Invited Guests,
Ladies and Gentlemen

Good evening to you.

On behalf of the Board and Management of Bank of Uganda, I am extremely honoured to host such a distinguished audience this evening. You may all agree with me that outside the formalities of the boardroom, engagements of this nature provide a more tranquil environment for us to review progress on areas of mutual interest, take stock of emerging risks and challenges and reflect on forward looking policy measures to support growth of the industry. I therefore hope my remarks this evening will stimulate some light conversation over dinner on these various facets.

I will focus my remarks on the following:

1. What we are observing as key **contemporary issues** that will impact the financial services industry in the short to medium term.
2. **Potential solutions** to these issues.
3. **Medium term initiatives** the Bank of Uganda plans to focus on and **near-term policy developments** being implemented in light of these issues and macroeconomic developments.

First, let us focus on the contemporary issues that we see shaping the industry in the short to medium term. These mainly fall under five (5) broad categories in our view, namely:

1. **Heightened credit risk exposures in the short term:** In response to the Covid-19 pandemic, financial institutions restructured a significant portion of their credit portfolio(s) guided by the regulatory forbearance permitted by BoU. With the expiry of the very last of the credit relief measures this month, the full effects of the pandemic are expected to pass through the balance sheets of SFIs, likely escalating credit risk. The current uncertainties in the business environment will only further heighten these risks.

2. **Disruptive competition:** The existential risks Financial Technology Companies (FinTechs) pose to the business models of deposit taking institutions are beginning to materialise in earnest. These risks, together with the high operating costs and rising costs of capital for traditional deposit taking institutions, are reshaping the competitive landscape of financial service provision, and will likely force a recalibration of strategy to respond to the new operational realities.

3. **Cyber security:** Cyber security risk may not initially be a major concern in the industry, but it can and should be said that these risks are an increasing function of financial service digitisation. This

positive correlation is exacerbated by the immediacy of customer service needs and the dynamic nature of the technology that enables this digitisation. From a risk management perspective, **COOPETITION** (*cooperation between competing companies*) within the broader financial service ecosystem may be required; as it can serve to minimise the actualisation of these risks and extinguish their impact across the sector.

4. **Evolving customer expectations:** Today's consumers are smarter, eager for higher efficiency, less sticky to service providers, and at the same time more informed than ever before. They not only expect but demand *'anywhere and anytime'* access and convenience out of their banking experience. This is further compounded by the nature of their demographic characteristics that are often at odds with the kind of clientele traditional financial services were originally designed for.

5. **Climate change:** Uganda being an agro-based economy, the industry cannot ignore the trickle-down effect of climate change to performance of its assets in the near to medium term. This is especially true given that increased Government focus on agro-industrialisation in the NDP III will likely increase demand for financing along the agro-value chain going forward. Additionally, output from the agriculture sector has major linkages with economic performance, right from food crop production which affects prices, to

provision of raw materials for manufacturers, to being a major source of foreign exchange through exports.

So the question is, how does the banking industry deal with such contemporary developments over the medium to long term? We see three major adjustments that may be needed over this time.

1. **Re-calibration of business models**: Increasing competition calls for a rethink and redesign of business models, in a manner that puts agility and flexibility in response to customer expectations and emerging risks from technology and climate change. Accordingly, SFIs will need to focus on creating sustainable improvements within their operations, to not only ensure profitability and the associated organic capital growth, but also future viability. The key risk here is existential, and it's about whether or not SFIs shall continue to exist and function in a future riddled with emerging developments like Open Banking, Artificial Intelligence, Robotics, Big Data, secure but real-time anytime and anywhere access to services, and ESG standards among others. Adaptation is therefore not just an option or preferred business feature, but rather an essential rule, and one for which agility and flexibility of business models, are but two central tenets.

2. **Greater understanding of customer expectations**: Today's customers expect personalised, meaningful, relevant and yet memorable

experiences in their interactions with you, the service providers. This may be through the simplicity, intuitiveness, and accessibility of a platform. This immediate gratification and weak stickiness to brands or providers, points to customer loyalty that is neither easy to acquire nor retain for extended periods of time. Looking ahead, the future generation of banking customers may be more biased towards and more preferring of omnichannel banking for example. How a financial service provider achieves this omnichannel centric service model, has a direct and positive bearing on its relationship and the experience it guarantees this future generation of customers.

3. **Use of technology to enhance compliance and information security**: With the right technology, banks can collect and mine data, perform in-depth analysis, and generate insightful reporting which is valuable for identifying and minimising compliance risk. Banks must also invest in the latest technology-driven security measures to keep sensitive customer information safe while considering some of the new trends such as open banking, which allows third parties carry out analytics using individual customer data.

How is the Central Bank responding to this changing environment?

To cope with these contemporary developments, BoU will focus on the adoption of new technologies in all core services, as part of its key priorities over the next 5 years. With respect to surveillance of SFIs, we will rollout

Supervision Technology (Suptech) to enhance our supervisory capabilities and data analytics. We will also issue regulatory guidelines for emerging issues such as cloud computing and cyber security.

Over several fora in the past few months, including the Annual Bankers' Conference, I have spoken about the need to incorporate sustainability issues in the financial sector. We aim to work with you to ensure that minimum environmental, social and governance standards are observed, by extending business models beyond the narrow creation of shareholder value to include sustainability concerns and their impact on society. Among other activities, we shall work with you to issue guidelines on climate change risk management in the sector and also incorporate climate change effects to our stress testing framework. In the near term, we are reviewing the Fit and Proper Guidance criteria for vetting substantial shareholders, Directors and Executive Management. This is intended to improve Governance standards and processes, by providing for a risk-based approach that reduces subjectivity and also reduces turn-around time in the vetting process.

Other medium-term activities to build the resilience of the sector shall include:

i) Increasing minimum capital requirements
ii) Fast tracking the development of the financial sector crisis management framework
iii) Reviewing and updating the macro prudential policy framework and tools

iv) Reviewing and updating the various legislations that level the ground and ease the provision of financial institution business.

Turning to monetary policy, BOU has been on a tightening path over the past 3 months and revised the Central Bank Rate upwards to 9% in the latest policy adjustment of August 12, 2022. As you may all be aware, inflation has become broad-based, and continues to rise as demonstrated by inflation statistics released by UBOS this week. These pressures are mainly as a result of disruptions to the global supply chains as well as reduction in local food production occasioned by adverse climate related factors. Our projections show that growth in the current year is projected to range between 2.5% and 3%, much lower than Government's desired transformative targets of 7%. The implications of this mild growth outlook pose risks which call for banks to put in place adequate measures to remain operationally resilient and sound.

On BoU's side, we shall continue to take action to prevent inflationary pressures from becoming entrenched, with an aim to moderate aggregate demand, and slow the rise in inflation as efforts to boost the supply side take effect. Additionally, the Bank has issued revised guidance on various financial market tools for monetary policy implementation, including:

i) Automation of the process to access the Standing Lending Facility, to provide banks more efficient access to liquidity in this tight environment. This automation took effect yesterday on 1st September 2022.

ii) Reduction of haircuts on collateral pledged for the Standing Lending Facility and introduction of the same haircuts on collateral pledged for reverse repos. This also took effect yesterday.

iii) Revision of the good for amount in the Interbank Foreign Exchange Market, to reflect the growth of the market since this measure was last revised in 2014. The new limits shall be effective on 12th September 2022.

On the regulatory front, I am happy to report that the Parliament of Uganda passed the critical amendments to the Anti-Money Laundering legislation on 30th August 2022, intended to strengthen the anti-money laundering regime. The amendments mainly cover aspects on identification of beneficial owners and proliferation financing spanning various Acts. Once assented to by the President, there will be a strong basis for review of the country's rating by FATF/ICRG, away from the grey list. I encourage you to not only continue demonstrating compliance with any issued guidance on AML/CFT risks, but to also embed AML/CFT risk management and mitigation in your practices and organisational culture.

Ladies and gentlemen, it gives me pleasure to note that despite the tough macro-economic environment that we find ourselves in, the banking sector remains resilient. Total Assets increased by Shs.2.14 trillion or 5%, from Shs.42.46 trillion at the end of March 2022 to Shs.44.61 trillion at the end of

June 2022. Over the same period total gross loans and advances increased by Shs.717.0 billion or 4% from Shs.17.87 trillion to Shs.18.59 trillion. The growth in assets was mainly supported by deposits which increased by Shs.1.55 trillion or 5.3%, from Shs.29.53 trillion to Shs.31.08 trillion over the same period. Similarly, the sector posted a higher profit of Shs.337.28 billion in the quarter ended June 30, 2022, which surpassed a profit of Shs.308.01 billion for the quarter ended March 2022. The ratio of non-performing loans to total loans improved slightly, decreasing from 5.79% to 5.32% over the same period.

Allow me to therefore applaud the Uganda Bankers Association and the individual financial institutions for this continued growth, the unwavering dedication to improve service delivery and the relentlessness in coping with the new realities of our dynamic environment. In the book of Habakkuk 2:2-3 (New Revised Standard Version) of the Bible, God responds to the calls of Prophet Habakkuk and says:

'…… Write the vision; make it plain on tablets, so that a runner may read it. For there is still a vision for the appointed time; it speaks of the end and does not lie. If it seems to tarry, wait for it; it will surely come; it will not delay.'

Writing the vision is a requirement from God because He knows that writing it down keeps it on the forefront of our minds. The things that we have written down and set our targets to achieve shall surely come to pass. With your continued support, the Central Bank will surely achieve its mission and vision.

I thank you all for listening to me and may the Almighty God bless you.

Bon appétit.

Michael Atingi-Ego
Deputy Governor