A Publication of **Credit Information Sharing Association of Kenya (CIS KENYA)**

Digest CIS Kenya

June 2020

Ushering a New Regulatory Regime

The editor's note

I am delighted to bring you this quarter's digest. In this issue, we will recount the various projects and activities in which CIS Kenya has been actively involved in the first and second quarters of 2020. Two main points will be the gazettement of the CRB Regulation 2020 and also the huge success of the Biennial 5th Africa CIS Conference held in Nairobi in February. We also have an article on the benefits stakeholders will derive from the new Regulations.

Risk-Based Pricing is another subject dear to us. The Regulations have made it mandatory for banks and other lenders to use a customer's credit score when appraising a credit application and in determining the interest rate to charge. CIS Kenya and CARE Risk Solutions, India organised an interactive knowledge session on Internal Credit Rating and Risk Based Pricing on 19th May 2020.

Across the world, people are being asked to stay at home and practice social distancing, to stop the spread of the COVID-19 virus. We will also feature an article on how on financial institutions can mitigate on NPLs.

In a nut shell, this digest will feature the following

- 5th Africa CIS Conference brief report
- Credit Infrastructure for Africa- keynote presentation by Luz Maria Salamina, Lead Financial Sector Specialist, World Bank Group
- Beyond COVID-19 Mitigating on NPLs
- CRB Regulations 2020; what is in it for stakeholders?
- Brief report on a Credit Rating and Risk Based Pricing interactive session
- Industry updates: Nimble Group partnering with the International Finance Corporation
- Pictorial

A huge thank you to all the persons who contributed writing the wonderful and inspiring articles, without which there wouldn't have been this newsletter issue.

Editor,
Ruth Kilonzo

1.0

5Th Africa CIS Conference 2020



The biennial 5th Africa CIS Conference 2020 was held at Windsor Golf Hotel & Country Club on 13th-14th February 2020.

The Conference was organised by the National Treasury jointly with CIS Kenya and with support from the World Bank and the Central Bank of Kenya. The theme for the Conference was **"CREDIT INFRASTRUCTURE FOR SUSTAINABLE GROWTH – *Entrenching Dynamic Assessment of Risk.*** Specifically, the Conference program addressed the comparative contribution of key components of Credit Infrastructure namely: *Credit Bureaus/Registries, Collateral Registries, and Insolvency /Debt Resolution.*

The Conference was graced by Economic Advisor to the National Treasury Dr. Geoffrey Mwau, The Deputy Governor, Central Bank of Kenya - Mrs. Sheila M'Mbijjewe, Lead Financial Sector Specialist at the World Bank Group – Ms Luz Maria Salamina (and other representatives from the WBG). Others included representatives of various financial sector institutions from Kenya and around Africa, including:

- Ministries of Finance (Kenya, Botswana, Madagascar) and Justice (Madagascar)
- Central Banks (Malawi, Zambia, Uganda, Tanzania, Ghana, Zimbabwe, Madagascar, Botswana, Sierra Leone)
- Commercial Banks (Kenya, Rwanda)

- Other Finance Institutions/NGOs/ Universities/Stock Exchange (Kenya, DRC, USA, India, Madagascar)
- FSDs (Kenya, Uganda, Tanzania, Rwanda and Zambia)
- Credit Bureaus (Kenya, SA, Nigeria, Uganda, Rwanda)
- Local MFIs, Saccos and CIS Kenya Governing Council members

Some of the topics discussed at the Conference included:-

- Overview of credit infrastructure in Africa
- Lending landscape in Africa: Is the future digital?
- Challenges brought by innovations in the credit market
- Responsible lending in the era of exponential growth of credit
- Credit bureaus: Trends and challenges
- Disruptive data sources in the credit information sharing industry: Developments and implications
- Evolution of traditional credit bureaus
- Alternative credit scoring models
- The Role of Regtech/Suptech in the credit market
- Collateral registry: Its contribution to improved access to Credit
- Risk based pricing
- Fraud prevention strategies for lenders
- Credit guarantee schemes
- Financial literacy and public awareness on the role of credit infrastructure

2.0

Overview of Credit Infrastructures in Africa

Presentation during the 5th Africa CIS Conference:
Luz Maria Salamina,
Lead Financial Sector Specialist, World Bank Group

Credit infrastructure is one of the most important tools that the World Bank considers as it promotes responsible lending. Credit infrastructure has three main pillars: credit information, secured transactions on collateral registries and, insolvency and the debt resolution regimes.

Scope of the credit landscape, in sub-Saharan Africa

Doing Business is one of the most important tools for measuring the ease of doing business and credit infrastructure has two main components or indicators within this tool. One is getting credit and the other is resolving insolvency. Sub-Saharan Africa is still very low in the measurement or in the rating of these indicators but there has been a lot of progress still.

Credit Information-Why does it matter?

Credit information reduces information asymmetries, contributes to borrower's discipline and reduces overall over-indebtedness. It also makes information to lenders available thus reducing the cost of lending. Also, it gives the regulator tools to track the country's credit performance and to make decisions and policies.

Depths of credit information ranking from the Doing Business consists of eight basic indicators. There used to be six. There are two new ones. One was to access online credit information and to have credit scoring. And this is how Sub-Saharan Africa and the various countries rate in the doing business:

Figure 1: Ease of Doing Business Scores - Sub Saharan Africa

Of the 48 countries from sub-Saharan Africa rated during doing business 2020, around 8 have the full 8 points or indicators. There have been important improvements in establishing the legal frameworks and the reforms needed to reach higher levels of these indicators. In 2010 there are some countries that got some ranking. But then from 2013 onwards it was eliminated; any one that did not get the 5 percent coverage of the adult population did not get any points for the doing business. We are beginning to have a mature market that is ready to promote credit through the use of tools that are made available through credit information.

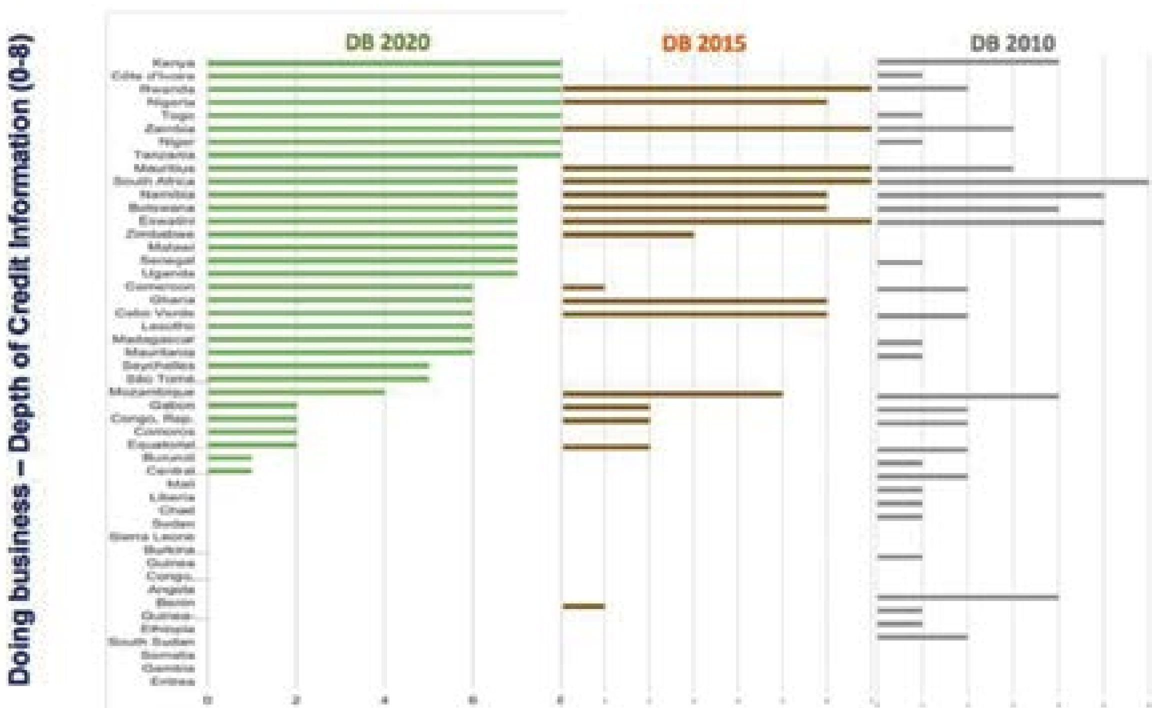


Figure 2: Depth of Credit Information

Alternative Data

The World Bank Group is promoting the use of alternative data and digital tools in client countries as follows:

- Tajikistan – Use of agronomy data to build credit scores for farmers
- India – Trade credit and utilities
- Bhutan – Alternative Data
- Bangladesh – Integration of alternative data
- Vietnam – Incorporation of mobile network data into the credit bureau
- South Africa – Pilot with National Credit Regulator
- Morocco – Launching a psychometrics scoring model for the largest MFIs with regulator support

The World Bank Group further supports the following:

- Adoption of unique identifiers
- Promotion of digitization of public information
- Open data systems and standards
- Digitization of government services
- Regulatory reforms for fintech lenders and expansion of information sharing
- Generation of credit registries (new role)
- Cross border collaboration
- Harmonization of data protection and privacy laws
- Capacity building
- Consumer awareness and literacy.
- Consideration of regulatory sandboxes; and
- Promoting risk-based pricing

Adoption of alternative data will go a long way in promoting inclusion of marginalized groups of societies.

When it comes to Collateral Registry, the main concerns are:

1. How can the creditor know that the asset offered as collateral is not already pledged to another creditor? They need to search the database of a Collateral Registry, where the security rights for all movable assets taken as collateral for loans are registered.
2. How can the creditor make sure that other creditors will not take his collateral? When the creditor registers the asset in the collateral registry, a "time stamp" is recorded and the rule of "First to Register" applies. This guarantees the priority right of the right creditors.

In case of default, how does the creditor collect the asset in a manner that is simple, affordable and fast?

• Extrajudicial:

(i) Repossession by the secured creditor

(ii) Settlement agreement in an alternative dispute resolution (ADR) mechanism, such as arbitration, mediation or conciliation.

• Judicial:

(i) The law should include specific fast track judicial procedures for the repossession and disposal of movable collateral.

(ii) Legal framework should include ways of enforcing security interests in movable assets. Have a centralized web-based solution or public registry available to creditors or their agents.

(iii) Law should allow parties to agree on out of court enforcement

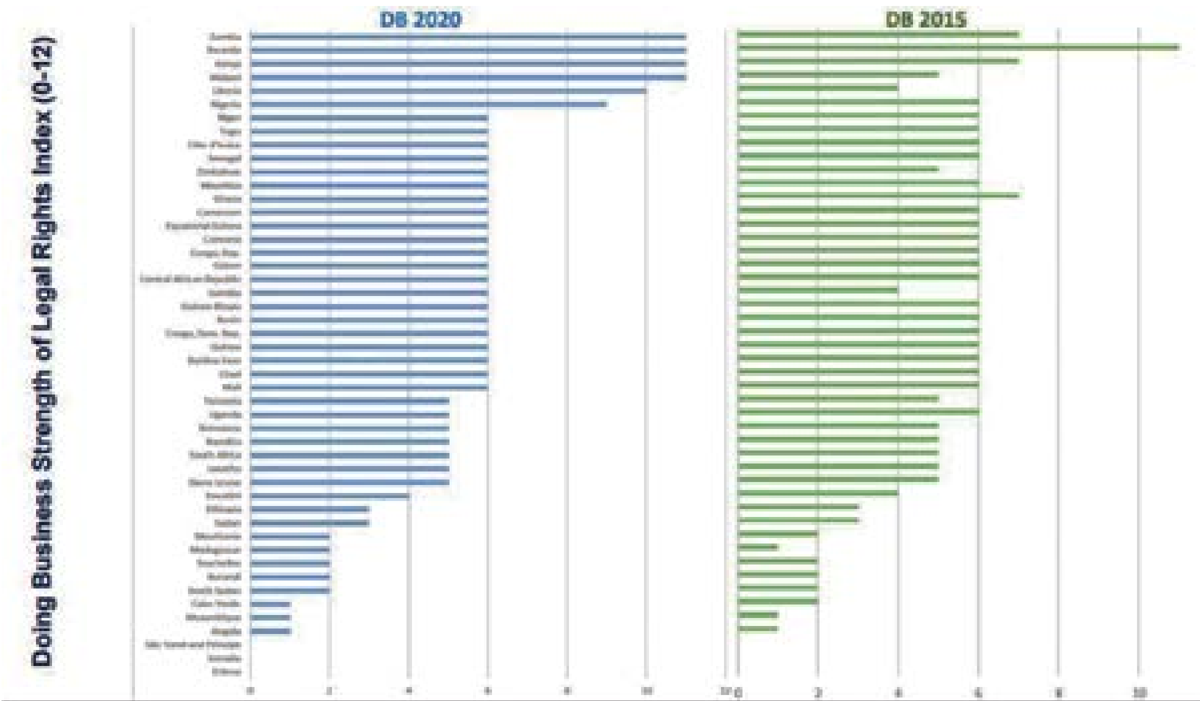


Figure 3: Strength of Legal Rights Index

Insolvency

A significant determinant of insolvency rankings in the DB report is the "strength of insolvency framework" index. This indicator assesses the countries' legislation in 4 major categories:

- Commencement of proceedings – Insolvency proceedings should be available to debtors and creditors and on the basis of both balance sheet insolvency and illiquidity
- Management of debtor's assets – The law should allow the debtor or IP to accept or reject ongoing contracts, avoid preferential or undervalued transactions and obtain post-commencement financing on priority terms
- Reorganization proceedings – The law should allow all creditors to vote on the reorganization plan and also provide equal and fair treatment to dissenting creditors

- Creditor participation – The law must require creditors to approve the selection of IP, the sale of crucial assets and also allow them to object to the admission of claims

The benefits of effective insolvency regimes include:

(i) Lower credit costs
(ii) Increased access to credit
(iii) Improved creditor recovery
(iv) Strengthened job preservation
(v) Promotion of entrepreneurship
(vi) Reduced failure rates for small businesses

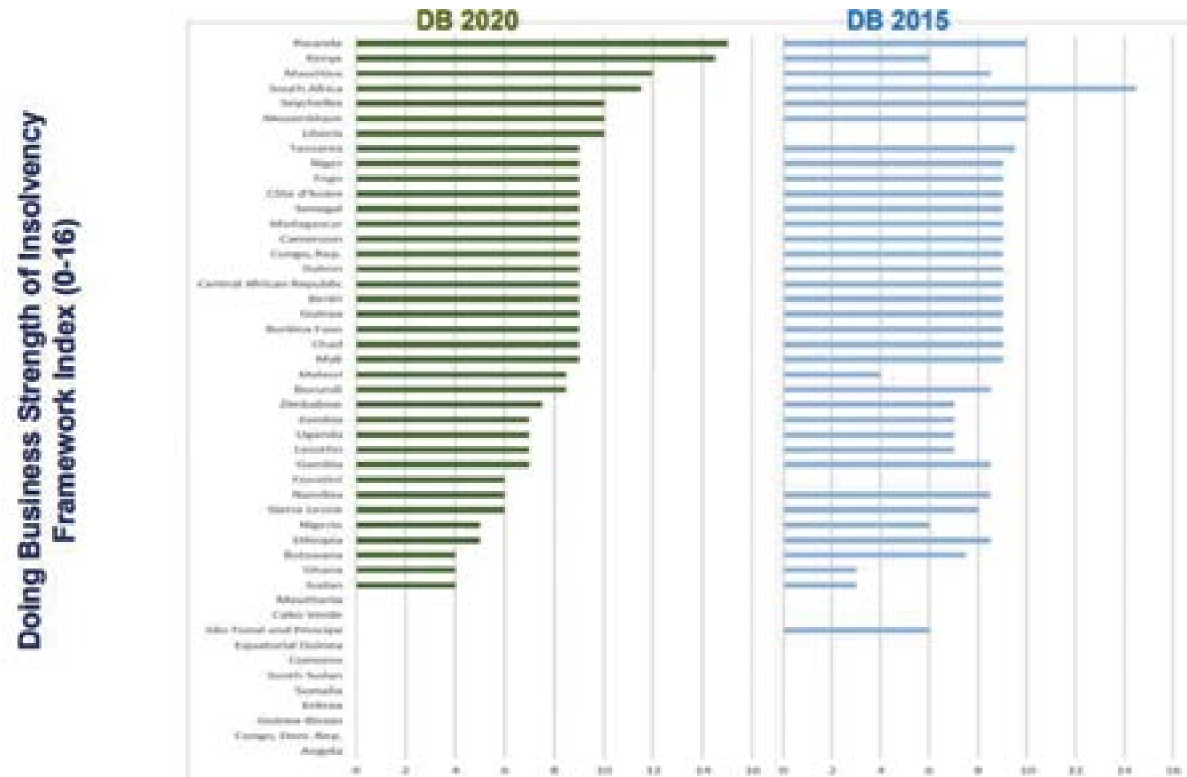


Figure 4: Strength of Insolvency Framework

Beyond COVID-19 Mitigating on NPLS

The novel corona virus pandemic has thrown businesses and financial institutions on a new normal. Objectives of credit providers have moved from growing the bottom-line to capital preservation. However, in the wake of the COVID-19 pandemic credit providers need to remain true and committed to their consumers. As communities take measures to contain the pandemic, credit providers should play their part by ensuring availability of credit to consumers and that they take advantage of the monetary support given by the Central Bank of Kenya. They should also give their consumers the much needed support to enable businesses and livelihoods build resilience during this crisis. There are two main ways of supporting consumers.

i. Loan Restructuring

Under this model a credit provider with the consent of the consumer extends the repayment term of the consumers loan facility for a reasonable duration. We currently do not know the full extent of the pandemic in Kenya i.e. whether treatment will have been found before too long. Therefore, credit providers should hold on the restructuring process until a treatment id found or there are clear indications that the novel corona virus can be medically managed. Loan restructuring works best when cash flow challenges are temporary or the consumer has not been badly affected. A restructure of a consumers' facility would be a good option since it speaks to their resilience. Credit providers also need to take note of businesses and retail consumers that are less hit by this crisis. This puts a credit provider's diversification strategy to test i.e. diversification by product or by sector.

For regulated institutions, loan restructuring processes have already been spelt out for them by the regulator. However, for non-regulated institutions they will have to rely on their internal policies to effect their restructures. Consumer empathy should be factored in by credit providers since consumers will remember how they were treated during this difficult time.

ii. Loan Refinancing

Under this model the financial institution evaluates a consumers total liability with an aim of consolidating them an offering a repayment plan that will help consumers meet their loan obligations. This will be the most probable scenario for retail and corporates consumers who will

be severely hit by the novel corona virus. Regulated institutions such as Commercial Banks, Microfinance Banks and deposit taking SACCOs already have guidelines that have been approved by their regulators. Non-regulated credit by industry practitioners.

The following tools will be useful to credit providers in evaluating refinancing proposals from their customers;

a. Credit History

The Credit Reference Bureau is your ideal partner of choice in the evaluation of your consumer's credit history and repayment behavior which account for a significant weight in the scoring of individuals and businesses. A consumers' credit history gives insight to the credit provider on the credit behavior of consumers. It is in the credit provider's interest to support consumers who move from good to "bad" categories based on the effects of the COVID-19 pandemic. Based on the information gathered the credit provider will then determine which consumers will be assigned higher credit limits under defined repayment terms. Credit providers are encouraged to refinance loan facilities so as to avoid total default, improve cash flows, reduce opportunity costs and ensure consumer relationships are maintained if not enhanced.

b. Cash flow Analysis

Some businesses have scaled down on operations only allowing the essential staff to run the day to day activities. A financial institution is also a business. It needs to improve cash flows of its consumers as it improves its own. The Central Bank of Kenya reduced the Central Bank Rate (CBR) by 100 basis points to 7.25% and the Cash Reserve Ratio CRR to 4.25% from 5.25% in a bid to improve the much needed liquidity in the market. We hope to see interest rate cuts in the pricing of loans being made by credit providers. Financial institutions will need to run analyses of their customers' accounts so as to better understand them. Evaluation of transaction/payments data (pre and post crisis) will be critical in identifying customers severely hit by the pandemic.

c. Relationship Management

Credit providers should also reach out to customer and offer refinancing terms especially to those customers with multiple facilities. Financial institutions should advise consumers on the two avenues (restructures and refinancing) that will enable them get back to normalcy. Personalized messaging via email, text messages and calls should encourage consumers to start negotiating terms that will be beneficial to them. Aggressive collection practices will not bear much result, since consumers are more concerned on their livelihoods. Waiving of late payment fees and soft collection strategies are encouraged.

We are down but not out! Stay safe!

Lemuel Mangla is the Head of Policy and Compliance, CIS Kenya

4.0

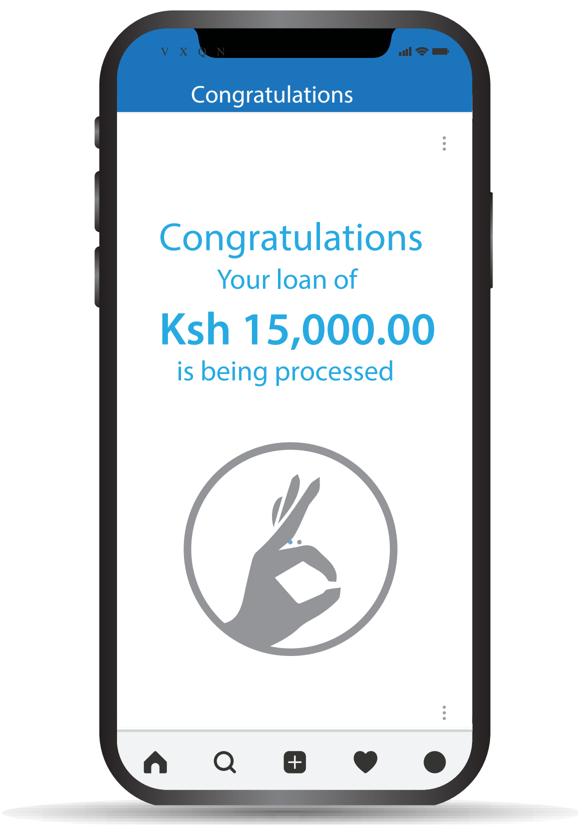
CRB Regulations 2020 Offer More Than 'Soft Landing' for Covid-19 Disruptions

The CRB Regulations, 2020 gazetted by the Cabinet Secretary to the National Treasury on 8th April 2020 introduced major reforms aimed at strengthening the credit information sharing framework in Kenya. Most people will remember these Regulations mainly for four prominent things: suspension of negative listing for borrowers affected by the COVID-19 pandemic; withdrawal of Central Bank approval to some lenders previously allowed to share data; reprieve granted to first-time applicants for clearance certificates and borrowers who default on principal loans of less than Shs 1,000.

This affirmative action by Government has proved to be hugely popular among many stakeholders who view it as sensible and responsive to specific challenges of credit consumers in Kenya. But these changes seem to have clouded a number of other reforms that are not pandemic-related, and which the Central Bank has been mulling over for a while now. One of the new measures is demand for increased transparency in the credit reports, which must henceforth include the name of the source of the negative credit information on any person. In the past, this transparency was only available in credit reports issued to the borrower and not to credit providers. It is important to note that credit reports issued to institutions will still remain opaque on sources of positive information, to avoid what is commonly referred to as "poaching".

Moreover, the revised Regulations have taken the agenda for risk-based pricing one notch higher. In order to reward borrowers who have a culture of good loan repayment, institutions are now mandated to use a customer's credit score when appraising a credit application and in determining the interest rate to charge. Good payers can now have a strong bargaining power

when negotiating loan terms. On the flip side, lenders are not allowed to decline loan applications solely on account of a customer's credit score. They can only reach a 'Decline' decision if there are other factors beyond the score and must give the unsuccessful applicant a written explanation of the full reasons on which the decision was based. In more mature markets, the credit score is a reflection of the sum total of the customer's risk profile and can therefore be used as a sole determinant on the decision, even to decline a loan. As the credit score in Kenya becomes more reliable, the requirement to forbid lenders from using credit scores as sole determinant when declining loans will not be necessary.



The new Regulations have also come to the rescue of consumers who transact several loan facilities within the month and whose loan repayments were previously not updated until month-end. Now data must be submitted daily, and such borrowers will enjoy much better credit scores that reflect their regular repayment habits, especially on mobile loans.

Furthermore, the Regulations now allow for the use of a central hub or an industry tool that facilitates centralized submission of credit information. This approach offers great relief to data providers who looked forward to a more efficient data submission process, especially in an environment of several bureaus. Single submission to multiple bureaus will make regular updating and also correction more efficient, especially where amendments are in response to customer complaints about data accuracy.

Saccos regulated by the Sacco Societies Regulatory Authority (SASRA) will no longer be regarded as third parties. Their recognition as subscribers gives them full powers in submitting borrowers' credit information to CRBs and also in receiving credit reports directly from CRBs.

In order to minimise the differences in standards applied to regulated verses unregulated data providers on data quality and consumer protection, the new Regulations now require that all third-party data providers subscribe to an industry code of conduct that will be approved by the Central Bank. The Code will set stringent standards that the industry must observe and an effective mechanism for addressing industry concerns in a more coordinated manner.

In the new dispensation, once a customer has raised a dispute, a bureau will be required to conduct investigations in a shorter time period of maximum 7 days down from the earlier 14 days. As a way of ensuring thorough investigations of customer disputes, credit information providers have been allowed a little more time to call for and review documents from their archiving agents. It is also important to note that the Central Bank is now an option of last resort in dispute resolution before aggrieved parties can seek legal redress from the courts.

In cases of unforeseeable circumstances such as the COVID 19 pandemic, the CRB Regulations 2020 empower the Cabinet Secretary to suspend some aspects of exchange of negative information and also to determine the period. It is under this provision that the Cabinet Secretary recently suspended negative listing for a period of 6 months up to September 2020.

Lastly, CRB Regulations 2020 allow regulators or supervisory authorities and credit reference bureaus and institutions to share credit information across borders. This will facilitate exchange of information where institutions operate in more than one jurisdiction. However, this will only apply where there is a reciprocal arrangement. The Central Bank is spearheading international cooperation to facilitate these cross-border data sharing arrangements.

It is therefore evident that the new Regulations cover a wide range of issues that will contribute to a more robust credit market in Kenya.

Jared Getenga, CEO, CIS Kenya

5.0

Interactive Session on Credit Rating and Risk Based Pricing

CIS Kenya in partnership with Care Risk Solutions India held an interactive session on Credit Rating and Risk-based Pricing on 19th May 2020 from 1100 hrs to 1330 hrs. The session which attracted 63 participants was led by Credit Risk Experts from CARE Risk Solutions with global experience of deploying Rating and Risk Based Pricing. The session format comprised of a short presentation, illustrations with excel workings and system demonstration on CAREs Credit rating/scoring module. Participants also had the opportunity to engage with the trainers during the Q & A session.

The interactive session aimed at exposing participants to credit reforms in the industry focusing on the benefits of internal credit rating framework and the different methodologies involved as well as the different components of Risk-based pricing in the context of IFRS 9 reporting.

The session was timely given the gazettement of the new CRB Regulations, 2020 which mandate credit to adopt risk-based pricing so as to promote responsible pricing and minimize over indebtedness of consumers. The Central Bank of Kenya had earlier introduced the Banking Sector Charter (BSC), 2019 as a measure to make the banking sector more responsive to credit consumers. Risk-based pricing is one of the four pillars of the BSC, 2019.

Lenders are increasingly adopting automated processes to minimize asset allocation bias and offer its consumers better customer experiences. As every lender strives to maximize return on equity, risk-based pricing ensures capital efficiency and growth of the bottom-line. Kindly visit the learning center to watch the session https://www.cislearning.org/webinars

6.0

Industry Updates

Nimble Group partnering with the International Finance Corporation

Nimble officially partnered with the International Finance Corporation ("IFC") in December 2019 to focus on the acquisition and resolution of distressed assets in South Africa and across sub-Saharan Africa. The IFC has taken an equity stake in our business and has provided significant capital with which to acquire distressed assets and we expect this relationship to be transformative for Nimble.

The IFC supports the development of strong distressed asset markets in emerging economies to ensure economic development and financial stability through its Distressed Asset Recovery Program ("DARP"), which has been successfully implemented in South America, Eastern Europe, Asia and the Middle East. Non-performing loan ("NPL") transactions are globally accepted as an integral part of any well-functioning financial market as they resolve challenges faced by both credit grantors and over-indebted customers.

The DARP unit gives credit grantors the ability to sell their NPL's while at the same time freeing up capital to invest back into their businesses. Credit rehabilitation and repair of individuals and small and medium-sized enterprises ("SME's") takes place where outstanding debt obligations can be resolved in a sensible and pragmatic way with the goal of preserving assets and enabling

customers to ultimately be credit active and re-enter the financial system.

Customer centricity and credit rehabilitation and repair form the foundation of our approach to resolving debt obligations. Debt forgiveness is one of the key tools to practically achieve this. It seeks to resolve the outstanding credit obligations of over-indebted customers while, at the same time, achieving meaningful socio-economic benefits. In an article written on our website in May 2019, we discussed debt forgiveness under a legislated framework as well as the large scale debt relief that is achieved through natural free market forces in the secondary market for the sale of NPL's.

The economic crisis unfolding in South Africa and across sub-Saharan Africa as a result of the Covid-19 pandemic will undoubtedly result in increasing levels of customer indebtedness as the economy slows, new credit extension ceases, business liquidity and profitability is adversely impacted and unemployment levels rise. At the same time, credit grantors will be under pressure as rising NPL levels will negatively impact earnings as well as capital adequacy requirements.

Our partnership with the IFC provides Nimble Group with significant organised capital to provide meaningful solutions to credit grantors to resolve income statement, balance sheet and other special situational challenges, such as the Covid-19 crisis. At the forefront of our investing philosophy is our commitment to treating customers fairly, while achieving credit rehabilitation and repair, in a manner that ensures the development of sustainable credit markets in sub-Saharan Africa.

Peter Watson is the Nimble Group Head of Investing
http://nimblegroup.co.za/partnering-with-the-international-finance-corporation/

7.0

Pictorial







Towards a more open credit market

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