CENTRAL BANK OF KENYA

Opening Remarks By

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At the

KENYA CIS VIRTUAL CONFERENCE 2021

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Good morning, everybody. Good morning, Jared and World Bank representatives, CEOs, KBA FSD Kenya, the rest of CIS representatives, everyone else at the conference, distinguished guests, ladies and gentlemen, a very good morning to all of you. I'm pleased to be with you this morning and grateful to the organizers for the invitation and for arranging this important virtual conference. Thank you, Madam Mbithi, for your remarks in terms of our support at the conference. But I think most of the work was done by you actually, all the work is done by you and your staff. And thank you very much for that. I'm informed that the conference brings together the leading sector at the leading sector players in Kenya's credit market. Most importantly the conference will review the impact of the coronavirus pandemic, and the related policy and regulatory interventions to the CIS mechanism in Kenya. So, the timing of the conference and theme is indeed apt.

This week on March 11 marks one year since the World Health Organization declared COVID-19 as a global pandemic. For Kenya, it will be one year on March 13, since the first confirmed case was announced. And as our Vice Chair has said, what a year 2020 was. Lives and livelihoods were impacted like at no other time in our lifetime, as governments, businesses, and individuals adjusted to the unprecedented measures put in place to contain the pandemic. At the Central Bank, we keenly observed the unfolding of the pandemic in China in early 2020 and its devastating spread to Europe and the United States in January and February 2020. In our mind, it was only a matter of when the pandemic would land on our shores. We therefore swiftly move within days of the announcement of Kenya's first positive COVID-19 case to instill emergency measures. These measures were intended to ensure the continued operation of the economy, by encouraging the use of digital financial services, providing liquidity to banks, ensuring business continuity, and managing the health and safety of bank customers and staff.

Turning back to the theme of today's conference, we also instituted various measures to manage the adverse impact that the pandemic posed to borrowers. The unprecedented containment measures put in place included movement restrictions, lockdowns, curfews, and up-ended lives and livelihoods. Business conditions and fortunes changed overnight, rendering previously successful business models redundant and put in 1000s of jobs at stake.

Accordingly, CBK spearheaded consultations with banks and led to an industry-wide initiative to restructure loans that were performing at the onset of the pandemic. This initiative was intended to cushion borrowers as they rode through the restricted containment measures. The restructuring period also enabled them to pivot their business models to fit the new realities accelerated by the pandemic, particularly digit digitalization. But it was not all doom and gloom as some of the borrowers were able to take advantage of emerging business opportunities, particularly in respect of manufacturing and supplying personal protective equipment such as face masks, masks, protective clothing, and sanitizers.

On the CIS front, we completed wide-ranging reforms at the height of the pandemic in April 2020. With the issuance of the banking regulations of 2020, these are the CRB regulations. The CRB regulations refreshed the framework that had been put in place in 2013 and which was in urgent need of an overhaul. Before I delve further into the reform, the issuance of the CRB regulations also provided an opportunity to provide relief to borrowers and address their pressing concerns. First. On April 14, 2020, CBK, announced the suspension for six months of the listing of negative credit information with CRBs for borrowers whose loans were performing previously and had become non-performing after April 1, 2020. This suspension did not apply to loans that were not performing before April on which the regular procedures continue to apply. Second, following public concern or misuse of the CIS system mechanism, and poor customer service, CBK withdrew approvals for unregulated digital lenders and credit-only providers to submit credit information to CRBs. Turning back to the reforms, concerns starting from the overhaul of the CRB regulations included the quality of data submitted to the CRBS, the use of CRB reports, and low public awareness of the CIS mechanism. Of grave concern to the public was the use of CIS to blacklist borrowers or to coerce them to pay as opposed to using CIS to price credit risk.

In a nutshell, CIS was not working with and for Kenyans. More broadly as you will recall the long-standing public outcry on the high cost of credit led to the enactment by Parliament of interest rate caps in September 2016. Regrettably, the caps adversely impacted those segments of the Kenyan population. They were intended to protect the majority of potential borrowers and the most vulnerable bank credit was unavailable. Micro small and medium-sized enterprises were shut out and had to contend with shylocks at highly unfavorable terms. Suddenly, this did not engender shared prosperity among Kenyans before the caps were repealed by Parliament in November 2019. So, to remedy this situation, CBK had been working with banks through the interest rate cuts period to regain the trust of their customers and the broader Kenyan population.

Accordingly, CBK set a vision of a banking sector that works for and with Kenyans. To operationalize the vision, CBK issued the Kenya Banking Sector Charter to the banking sector in February 2019. The charter is anchored on four pillars, customer centricity, risk-based pricing, transparency, and doing the right thing. All banks were then required to formulate board-approved implementation plans that would operationalize the charter. All banks formulated and submitted this plan specifically in 2019. Implementation progress is reported to CBK every quarter. Of particular relevance, this morning is the risk-based pricing pillar, which I will focus more on. This is not to negate the other pillars, as they all interlink but is to focus on the theme of the conference.

The risk-based credit pricing pillar requires that loans should be priced responsibly. They should be based on the customer's risk profile and all positive and negative information from CRBs. It was therefore imperative to pull the CIS by, among other things, increasing the source of information enhancing the frequency and integrity of the data reported to the CRBs, and training advanced to entrench risk-based credit pricing. We have in recent months been engaging each bank on its risk-based credit pricing model. The overarching philosophy is to ensure that each borrower's credit risk is appropriately assessed and priced. This inevitably ensures that all relevant information particularly CRB reports is taken into account in credit risk pricing. This is a journey we have embarked on with banks we know that it is not easy but it is necessary for restoring the confidence of customers.

Now I want to digress a bit here because there's a general feeling at times when I speak to some people that our customers don't understand or this is very complicated etc and my point is you know a journey of 1000 miles starts with one step starts with a single step so from the perspective of CRBs and indeed banks, you don't need to have you know the perfect model as you start. I think we all know that you become better with time and we understand you get more information in a sense that is what most of us who are good or those that are data experts that's what they do so at the beginning of limited information but you expand the information set so your model becomes let's say more efficient and in terms of calculating the risk.

Another issue that they also need to put on the table which is at times we think that customers are not very sophisticated and therefore don't understand risk pricing etc. I will put you two stories that prove that our customers are very sophisticated in this market. There's a story that I really like and I think it's also appropriate today. Yesterday being international women's day, we discovered that in one of the lending platforms in Kenya, most of the digital transactions were taking place between three o'clock and five o'clock in the morning and more than half of those transactions were by women. So we delved a little to understand what was going on behind this and the story that presented itself is actually fascinating it's been written up in various places in the newspapers etc around the world also and basically what we discovered is that around three o'clock the mama mbogas that we all know very well, wake up in the morning and then borrow get credit from this platform, this is a three o'clock in the morning they'll then send a message to the wholesale at Marigiti, etc or the equipment you know around the country and request for their produce for the day to sort in two days. They would then send a message to the mkokoteni guy to deliver them to their kiosk then they'll wake up the kids, feed them, wash them, send them to school and at 6.30 am they will make their call again or they'll do the transaction with the Boda Boda person who delivers them at 6.30 am or whatever time it is they're at the store. Now what we found interesting, is that you can see it has really changed the way society operates. And the benefits to this lady who otherwise would have to be in Marigiti and other places like that at three o'clock in the morning to get the best products, etc. But what is also interesting is, she repays at the end of the day, it's actually a 30-day loan. So, from an economist's perspective, it doesn't make sense. Why is it that she wants to repay at the end of the day, and then tomorrow morning will borrow again, as opposed to just keeping the money for 30 days. And the answer, as we found out was very simple. They had figured out the algorithm of the platform, and they figured out that they are repaid. And you know, for 30 times that is in one month their transaction limit will be much higher. Right? Instead of waiting for 30 months, or actually more like 34 months, two years, so as to increase the credit limit, they much prefer to repay every day, and the 30 times was sufficient for them to go into a significantly higher credit limit. It shows that our people are actually, this is not somebody who has gone to university, Ph.D. or whatever else it is, but some people fully understand what it is.

A second story that I'll tell you, again, to make this point that our people are actually very, let's say very sophisticated, or savvy in financial service. This is more than 10 years ago; I was not in this country then. But I had come back. And, I was talking to my aunt then she was already past eighty years old. So, she had come home and she gave me two of our phones, she had two phones and asked me to charge them to connect them to the power supply. So, I asked her, why do you have two phones and she explained to me that, at particular times of the day, she uses this phone. And then at other times, she uses the other phone. She had figured out the pricing model for both of them. So, it goes down to appreciate that our people are truly sophisticated. And this is not something that CIS or the CRB system could say will cause them grief. On the contrary, once they will understand it.

I think what stops us is all our feeling or what we can, you know, our feeling of how fast we can move ahead. And I think this conference really allows us to set our sights much higher so that over the next few months we can continue renovating or should we say improving on this CIS system.

So, as we mark a year since COVID-19, landed on our shores, it's up to us to reflect on the journey. What have we achieved? What are our challenges, and most importantly, what have been our learnings? On the broad front, the Kenyan banking sector has remained sound and resilient. Drawing on capital liquidity buffers that were built before the pandemic. The emergency measures put in place by CBK have seen the banking sector continue to operate. Even at the height of the containment measures. Over 90% of bank branches remained open across the country. Even in areas that have been locked down, with the adoption of digital platforms, over 95% of transactions are now conducted outside bank branches.

On loan restructuring, by the end of January 2020, 57% of the gross loan portfolio amounting to Ksh 1.7 trillion, have been restructured. This provided space for borrowers to ride through the pandemic, mitigate job loss, and pivot their business models to the new normal. For banks, the restructuring provided time to build additional capital and liquidity buffers to sail through the turbulent pandemic tights.

The six-month suspension of the negative listing of credit information ended on September 30, 2020. Thereafter, the existing procedures for risk classification of loans with respect to their performance and consequently listing with CRBs apply. A further transition period of three months was provided before their loans could be reported to CRBs as non-performing. This measure provided borrowers whose loans were performing at the beginning of the pandemic with a space to rearrange their affairs while ensuring their credit history was not adversely affected for no fault of their own. It was, however, important to restore existing procedures as the pandemic containment measures were what is. This is to ensure that the credibility of the CIS mechanism is maintained and the loan repayment culture among borrowers is not impaired.

As I go to a close, while they say it is darkest before dawn, we cannot declare victory yet, a lot more remains to be done in three broad directions. First. The journey of entrenching risk-based pricing in banks continues. CBK will continue working with banks on this journey, we will not perfect it in a day. But we must dare to take the first steps. Only if we carry along customers, will we make giant strides on this journey. It may seem like a long and distant journey. But we have made significant progress so far. And I look forward to further milestones in the coming days. Second, the more information sources we have in the CIS, the more credible it will be. However, the sources of this information must be legitimate and not misuse the CIS to detrimental powers. We are in this regard working with parliament and other players on the enactment of a legal and regulatory framework for digital lenders that focus on appropriate market conduct. Third, and perhaps most important, is sensitizing the public on the CIS mechanism. This should be done in simple terms to break down for instance, what a CRB report is, and what does the score mean? To many Kenyans the CIS mechanism remains a black box with even the well-heeled, not being able not being aware of what their credit score is or what it means are still being confronted with different scores from the three CRBs. I am sure that you will this morning deliberate on the challenges but more importantly, the opportunities arising from the pandemic, as they say, we should not let a good crisis go to waste.

Thank you very much and thank you for your attention.