

## INTEREST RATES ENVIRONMENT

**Admin:** Welcome to My Chat with a Bank CEO, Q1/2014 edition. Our topic today is the interest rates environment...the discussion is hosted by Arun Mathur, CEO of I&M bank.

### General Questions

**Jackson Okoth:** While the Central Bank Rate (CBR) has remained at 8.5 per cent since May 2013, banks have not responded by cutting down their lending rates. Why is this?

**Arun Mathur:** Good morning all, my name is Arun Mathur and I am happy to be here to have a chat with you about interest rates.

Banks say lowering rates is sometimes problematic, due to Expensive deposits...but mostly these interest rates are from the most wealthy of this nation, isn't there a way to balance, because a big chunk of Kenyans will deposit their few thousands, compared to the much wealthier who will deposit their millions with you?

The interest rates for lending are based on the spread over our cost of funds and also the risk of the borrower. Obviously the large corporate customers get more favourable rates than an individual who is borrowing a smaller amount which may or may not be fully secured.

The CBR is more of an indicative rate and may provide direction in terms of interest rate stability. It is interesting to note that most banks are still offering deposit rates that are over 10% per annum.

Banks are today putting rates below base rates for quality customers which would also include customers who have had a good track record with the bank.

According to Central Bank statistics interest rates have declined from an average of 19.3% per annum in 2012 to 16.8% as at December 2013. And this trend is likely to continue into 2014.

**Joan Wairimu:** Sadly, all these measures like your answer above are at the discretion of a bank?

**Arun Mathur:** Thank you Joan for your comments on deposit rates.

Banks are accepting deposits for lower amounts and the rate for a three month deposit is quite attractive and compares well with the deposit for say KES 1,000,000.

The higher the deposit the depositor is able to negotiate for an improved rate of interest especially when there is a liquidity crunch. With 43 banks and stiff competition for your business, the deposit rates are not exactly in the hands of a bank and it is subject to supply and demand.

**Dannish Odongo:** Just a quick question. Sacco's do not have big financial muscles like the banks yet their interest rates are fairly stable and low at 12%, can banks adopt some Sacco's ways?

**Arun Mathur :** Hi Dannish, your question is very valid.

Banks also have to maintain liquidity and cash ratios and also have to pay deposit insurance premiums for the entire deposit portfolio.

Therefore deposits in a bank are guaranteed up to an amount of KES 100,000 per depositor. Also, the borrower and shareholder in a Sacco are the same group of people and the returns are reflected in the pricing.

**JACKSON OKOTH:** The Central Bank of Kenya has moved the period after which provision is made for a bad debt from three to two months, how is this going to affect operations of commercial banks?

**Arun Mathur :** Hi Jackson, thank you for your questions.

The Central Bank provides guidelines on classification of loans and the provisioning thereon. Banks are adequately capitalised to ensure that any adverse provisions can be absorbed.

**Everlyne Ngare:** Given the CBKs decision to maintain the CBR rate at 8.5, do you view that as complacency rather than reducing the CBR to allow the country experience growth?

**Arun Mathur:** Thank you Everlyne.

The decision by the CBK to maintain CBR is also a sign to maintain inflation within target and therefore promoting steady growth.

### **Credit Information sharing**

**Dennis Karanja:** What impact do you believe Credit Information Sharing will have on bank interest rates?

**Joan Wairimu:** Has Credit Information Sharing started to bear fruits in the positive side, where one can negotiate for better rates out a good record? Do you have any statistics?

**Arun Mathur:** Hi Dennis and Joan. Good questions, thank you.

The Credit Information Sharing has already impacted in terms of quicker turnaround times and decision making for those customers who have a clean credit history.

It has definitely helped in issuance of credit cards .The next area where it is going to have an impact is on home loans i.e. the tenor as well as interest rate. And also it could have a bearing on the value of the collateral.

Banks are already beginning to work with the CRBs. It would also be a good idea for customers to ask for their credit reports from the CRBs.

Each customer is entitled to one free report per annum.

The comprehensive information sharing was only gazetted last month and you are already seeing that banks are offering products based on positive information.

**Angela Nyabera:** I understand the bank like any other business has to make a profit and has operational costs to consider, but is the final interest rate charged by banks regulated by anyone or it's at their discretion? Kindly educate us on this.

**Arun Mathur:** Hi Angela, thanks for your question.

Interest rates are not regulated but interest rates that we charge are market driven and therefore not at the entire discretion of a particular bank.

It is therefore advisable to shop around as the variety of products available in the market is quite varied and can suit all kinds of requirements.

It is also useful to develop a track record with the CRB and use that information to benefit on pricing and other terms.

**Dennis Karanja:** From a CEO perspective, what is the risk posed to your core lending business by innovative lending products that use business intelligence, data mining, algorithmic scoring to better predict default rates, low risk customer segments and effectively offer a lower interest rate? Are you aware of local banks who have invested in this technology?

**Arun Mathur:** Hi Dennis, another good question.

I would like to say that banks would be very happy to process online loan applications in order to hasten the turnaround times but we have to go through a lot of manual process in terms of documentation.

As far as credit scoring is concerned it is already happening for home loans and certain consumer loans and this is a useful tool.

It is likely that we will be able to invest in technology to create a database so that we can also decide what sort of loan products we would like to promote at different times.

The technology for data mining is just coming into the market here in Kenya and it takes around three years to be able to get the correct analytics for the kind of predictive default rates that you have referred to.

**Stephen Cheboi:** kindly share the impact of prudential guidelines and consumer protection Act, if a borrower borrows loan on a fixed interest rate, takes a loan for a period of 5years but decides to buy off the loan after one year, can the bank charge interest for the entire period, or for the period they had the loan?

A bank cannot lock in a customer for a particular period and rate of interest. A customer is entitled to repay a loan early either in part or in full with no penalties.

## Mortgages

**Gulleid Gulleid:** Why are the mortgages lending rates high and what are banks doing to lower the lending interest rates in order to support Kenyans in building their own houses?

**Arun Mathur :** Hi Gulleid, I saw your question about mortgage rates.

First of all let us see how mortgage rates are determined. The rate of interest on a mortgage has to be compared with the interest free return on a 10 or 15 year Treasury bond.

You will observe that in this segment the rates being offered for a mortgage are quite close to the yield on bonds. Therefore a long term interest should not be compared with a short term interest rate such as an overdraft for one year. Banks also are required to raise long term funding such as bonds to match their mortgage portfolio.

Presently much of the mortgages are being financed through three month and six month deposits so there is a risk mismatch which must be factored into the pricing.

**Joan Wairimu:** Sir, while still on mortgages, how long do you think it will take to get more Kenyans to take mortgages? The number is put at 20,000...affordable mortgages?

**Arun Mathur :** Hi Joan, if only we could get documents registered in a shorter time, we would be able to increase the number of home loans to our customers. I must add that this is a priority area for all banks and we are all keen to push this product which is of immense benefit to all Kenyans

Through KBA the industry is also engaging with the Government to streamline the process including addressing the inefficiencies in the lands office.

We are supporting the creation of capacity in the lands office to be able to process multiple units simultaneously.

**Joan Wairimu:** Is that the major concern on affordable home loans? Please list others...if any.

Hi Joan, I recognize your concern about affordable homes. There is also a shortage of affordable homes that we can finance.

JACKSON OKOTH: Grapevine has it that a Chinese bank is planning to enter the Kenyan market, a move that complicate the interest rate environment and may drive many banks out of business. What is your take on this?

**Arun Mathur** : Hi Jackson, interesting question

We already have 43 banks and various mortgage finance institutions in Kenya. If another bank comes in it will not only have to match pricing but also the product features and the quality of service.

The entry of additional banks will merely increase the choice available to customers.

**Gulleid Gulleid:** Sir, I hope when it comes to mortgages document processing and the rate there is big difference and believe the problem lies with the banks and not Ministry. So how can the banks create an affordable home loan to all Kenyans but not only few Kenyans like CEOs?

**Arun Mathur:** Hi Gulleid, let me clarify on affordable homes.

We need to have more developers who can provide low cost housing and this has to be done in quantity so that the availability can be improved. Even if the cost of finance came down drastically the basic cost of the house is the real issue.

JNAMASAKA asks... @KenyaBankers this is a question for Arun on my chat with the CEO. Are we likely to see interest rates in Kenya drop to a single digit?

**Arun Mathur:** Hi Joy, thanks for your question.

We also have to look at the savers who would be badly affected if the interest rates came down to single digits. What is important is that whichever way interest rates move, it should be a gradual process so that it does not hurt savers.

Looking to competition we are seeing a steady reduction in interest rates and hopefully we may see a single digit situation in the not too distant future. In the long run low interest rates with a stable exchange rate will be beneficial to all.

**Steve Muia:** We have seen banks posting increased provisioning in their full years for 2013; can this be attributable to high interest rates or new CBK regulations?

**Arun Mathur:** Hi Steve, you will have observed that banks have been lending a lot more as seen by the sharp increase in the loan figures which now stands at KES 1.6 Trillion as at December 2013 which is a significant contribution to economic development.

Given this increase in the loan portfolio, the increase in provision is very much in line.

**Abu Salim:** Hi sir, would it be right to say the most significant matter is the spread by banks affecting the market interest rates? With recent research showing average of less than 10%.

**Arun Mathur:** Hi Abu, thank you for your question.

The spread depends on the kind of products and access to deposits that a bank has. Some banks have spreads which are as low as 6% but their non-performing loan ration is also less than 2%.

It is possible that banks with a higher spread are having a wider network of branches and have higher operating costs but are able to garner lower cost deposits.

**Stephen Cheboi:** Thank you for that answer, now in case an errant bank insists that a borrower must pay interest for the entire period what is the borrowers remedy?

**Arun mathur:** Hi Stephen, I would expect all banks are fully compliant with Central Banks guidelines on consumer protection so I don't expect this to happen in Kenya.

**John Komu:** Thank you for this very enlightening chat session.

**Arun Mathur:** As we are coming to the end of the session let me thank Habil, Abu, Joan, John, Gulleid, Everlyne, Angela and everybody else for the very interesting questions. Best Regards to you all.

### Unanswered Questions

**Joan Wairimu:** By far that rate is like a benchmark, how come there is such a huge gap between the banks and the lending rate?

**Joan Wairimu:** How can the market interest rate spread be addressed?

**Dennis Karanja:** Hello everyone. Thanks Admin. Interest rates affect Kenya's Vision 2030 goal of becoming a middle income economy. What plans are there to have 30year mortgages at 3-6% like the west?

**JACKSON OKOTH:** The Central Bank of Kenya has moved the period after which provision is made for a bad debt from three to two months, how is this going to affect operations of commercial banks?

**Pinky Pravin:** what is your view on the super profits that banks are making and what constitutes a reasonable return on investment in declining economy?

**Chat Admin:** Next week we chat at 10am with Sammy Itemere of Equatorial Commercial Bank...the topic is on SME opportunities and challenges