

## CEO Chat September Edition

### Industry Proposals on Reducing the Cost of Credit



## “My Chat with a Bank CEO”

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*Dhiren Rana, CEO Middle East Bank*

*Chat Summary*

*Friday 5<sup>th</sup> September 2014*

*Topic: Industry Proposals on Reducing the Cost of Credit.*

*Time: 10:00am-11:00am*

### Content

- 1. Industry Proposals on Reducing the Cost of Credit (KBRR and APR)*
- 2. Credit Access and Financial Literacy*
- 3. General Questions, Comments and Feedback*

## Industry Proposals on Reducing the Cost of Credit (KBRR and APR)

**Dhiren Rana:** I wish to welcome everybody on behalf of Kenya Bankers Association

Today we will discuss the Total Cost of Credit...the Annual percentage rate (APR) ...and the KBRR, or the Kenya Banks' Reference Rate

Moreover, we will also interact to discuss what banks in Kenya are doing to enhance access to credit and to reduce the interest rate

I look forward to an interactive session

If you do not know technicalities about APR and KBRR please do not worry because I am here to clarify and demystify these terms

**Zena Rashid:** Welcome Mr. Rana

**Dhiren Rana:** Welcome Zena...great to have you here

**Chat Admin:** Thank you Mr. Rana for those words of introduction. We now welcome questions from those logged in.

**Dhiren Rana:** Let me share some thoughts as your observations come up

It is encouraging to note that credit to small and medium sized enterprises has grown by 40 percent in the last one year...

...banks in Kenya principally focus on serving SMEs and individuals and families for their financial planning needs.

This is really to encourage all the participants in today's discussion to seek access to banking facilities in Kenya without hesitation...it is for this reason that we host the CEO Chat...so as to have an interactive engagement and give you an opportunity to share your thoughts on how you think the banking industry will continue serving you

The growth of the economy comes through increased activity countrywide, and SMEs are very important players in generation of economic activity and that is the reason why banks as service providers are focusing on SMEs

Therefore...cost of credit and interest rate are key concerns to consumers, businesses/SMEs...as well as banks

**Mbatia James:** I salute you all

**Dhiren Rana:** Welcome Mbatia James. Greetings to you!

**CHRISTINE VULIMU:** Glad to be part of this discussion

**Dhiren Rana:** Since the introduction of the total cost of credit initiatives...most recently the APR and KBRR, there has been a huge public interest on how it will positively affect their access to banking services

These initiatives became operational from 1st July 2014... Although it is still early days...within the short period that these initiatives have been in place...we are already seeing strides in so far as transparency around pricing and a response in terms of credit uptake

Banks are also trying to promote awareness amongst their clients regarding these initiatives

**CHRISTINE VULIMU:** How are the banks regarding this? Communicating to the common mwananchi

**Dhiren Rana:** Thank you Christine for your feedback

Kenya Bankers Association as well as Central Bank of Kenya have already done a media campaign to inform public about initiatives to bring down the cost of credit, specifically the Annual Percentage Rate / APR and the Kenya Banks Reference Rate / KBRR

...some of the avenues of enhancing awareness include today's CEO Chat

Individual banks are making attempts to communicate APR to every prospective loan borrower...so that is another communication channel which will help consumers comes to an informed decision

**Conrad Karume:** Thank you for the insights Sir. Will the new rates apply to loans taken prior to the introduction of the APR and KBRR rates?

**Dhiren Rana:** Welcome Isaac and Conrad to the discussion...

Conrad...APR and KBRR are operational for all new loans and new credits from July 2014..and the same will be operational for all earlier loans and credits over a period of the next 12 months, which is the transition period

**Conrad Karume:** Thank you Sir

**Isaac Kiplagat:** Mr Dhiren Rana, this takes us back to regulatory and policy issues. I personally don't believe that competition in banking sector in Kenya is stiff enough to apply pressure on credit issuance.

**Dhiren Rana:** Isaac to your point about competition...APR is actually a comparison tool where a consumer is able to compare total cost of credit from different competitors. Therefore, one can approach a number of banks and get the APR quotes and make an informed decision. This is already operational. This will increase the competition across the various loan products that banks offer.

**Isaac Kiplagat:** Well answered Rana

**Simon Lee** : the cost of credit calculator clearly shows the high cost of external charges such as legal fees. Are banks looking at or currently provide these services in house at a cheaper rate to reduce the overall cost of credit?

**Dhiren Rana** : Thank you Simon ...you are bringing a very fresh line of thinking to the discussion

...the Kenya Bankers Association in partnership with Central Bank and the Treasury are working reforms and strategies that can reduce the costs of external charges.

There are several initiatives at the concept stage, including creating a digital movable assets registry and a securities (collateral) depository, which will allow transfer of securities from one institution to another without having to discharge and charge securities again...this will be more like the transfer of shares at the CDS...and will eliminate high legal costs and also considerably reduce the time for transferring securities

I want to say that Kenya Bankers Association and Kenya Association of Manufacturers have been appealing for the past several years to the Chief Justice concerning need for lowering the tariff under the advocates remuneration act. We are continuing our efforts in that direction.

**Peter Ng'ang'a** : Bwana MD, following the chat there's good that comes KBRR and the need to grow the lending market. My question is, what are the financial institutions inclusive of the central bank doing in strengthening the Financial Risk Management systems in Kenya.

**Dhiren Rana** : Welcome Peter Ng'ang'a

You have a very important question

...for the last decade or so, a lot of work has been going on to strengthen financial risk management within individual banks; also in the supervision of banks by Central Bank of Kenya

...various technology based tools are also deployed to identify financial risks and to better manage them

...these include technology surveillance against frauds, and mechanisms such as credit information sharing, etc.

...these help banks avoiding risky propositions and also to guard against frauds.

despite many fold growth of the banking services in the country over the last decade, the stability of banks in Kenya has not been compromised this is the result of new found focus on financial risk management within banks and at Central Bank

**Peter Ng'ang'a**: Thank you MD

**Kepha Msafari**: Demand and Supply determine the cost of goods and services. How is the Kenyan banker able to control this in relation to credit? Is KBRR tied to this?

**Dhiren Rana:** Thank you Kepha

Demand and supply factors ultimately decide the market interest rates...which get factored into KBRR; therefore, KBRR is a representative mechanism of market demand and supply.

...

**Dhiren Rana:** Before we wind up...I want to simplify KBRR term

This reference rate is a uniform rate adopted by all banks in Kenya and KBRR / Kenya Banks Reference Rate brings to an end the system of base rate

The fixing of base rate and the choice of time of changing the base rate was earlier discretion of every individual bank...

...now, Central Bank publishes KBRR, which is an arithmetical average of 91 day treasury bill and the Central Bank Rate / CBR

Banks now quote interest rate in their letters of offer at a given margin above KBRR

Therefore, it makes it very easy for customers to compare the cost of borrowing from different banks, and the customer also is assured that whenever KBRR comes down, simultaneously the cost of borrowing will come down

This brings in an element of competition and enhanced transparency and these two elements will eventually help reducing interest rates

### Credit Access and Financial Literacy

**KIBET LANGAT :** On the growth and development of SME's, are there sectors of our economy that you consider "unbankable"? The development gap has been rather slow.

**Dhiren Rana:** Kibet...morning...

**KIBET LANGAT:** Good morning sir

**Dhiren Rana** ...I do not think that there are sectors within SMEs that we consider unbankable

Maybe I can ask you Kibet...do you have a specific sector in mind?

**KIBET LANGAT:** I asked that because there seems to be little penetration especially in my rural area with very little awareness on the products

**Dhiren Rana:** Kibet...thank you for clarifying...and I am sure banking is penetrating fast even in your area as more financial services providers...including banks and bank agents...provide access to financial services in rural and remote areas

**Angela Nyabera:** Hi Bwana CEO, for many SMEs in Kenya, one of his biggest problems has been securing cash flow for day-to-day operations. The challenge faced by most SMEs is that they have relatively low cash reserves hence are constantly relying on chasing one client or another to be able to manage operations. But even getting an overdraft facility from a bank still requires title deeds, log books or some form of security and that is such a pain area for startup businesses. Especially those not dealing with actual stocks e.g. Software development companies. It would be great if our banks cost of credit favored such businesses.

**CHRISTINE VULIMU:** Thank you Angela. You are speaking for the majority of Kenyans who could contribute a lot if this was addressed.

**Dhiren Rana :** Welcome Angela

Angela...to address your point...you make very pertinent observation

...as you are aware various segments of entrepreneurs are served by sector specialist institutions...

...for example, micro finance institutions serve micro enterprises quite well compared to commercial banks

**Angela Nyabera :** Correct

**Dhiren Rana** ...SMEs are served by commercial banks

...SACCOs are very important service providers and they too provide significant access to financial services...I believe Kenyan financial services sector is growing rapidly and in coming years will fully meet financial services requirements of all Kenyans

I also want to say that banks have specific products to bridge cash flow needs of SMEs...and collateral requirement is based on the size of exposure as well as cash flow assessment by the bank...this is why startups may typically experience challenges in accessing credit from a commercial bank

However...if a startup is eligible under specific structured trade finance they may be in a position to get overdraft or short term loan from a bank

**Angela Nyabera :** Thanks Dhiren, that's something worth considering / thinking about

**ENOCK OGUTU:** Apart from the several initiatives spearheaded by the banking industry to enhance credit access, what can you tell those who want to borrow but still cannot access credit because of lack of security?

**Dhiren Rana:** Thank you Enock...

...collateral is important but when there is a sound business case and clean credit standing of a borrower then banks will be in a position to provide credit such as LPO financing...discounting of cheques...or a small short term overdraft

**Mbatia James:** I think banks are missing a point, it's not about how easy people will have access to cash, but how they gonna use the funds. I'm sure all banks offer credit in exchange for collateral. Most people don't have the basics for running businesses, so they end up creating a fragmented industry with a low return of capital in the late entrants, which end up frustrating themselves. Losing property along the way.

We need a platform that will offer entrepreneur education.

**Dhiren Rana:** Mbatia James...I do agree that there is no formal training mechanism for first time users of bank credits on prudent use of the money that they borrow

This financial literacy area is one that perhaps we should put more emphasis on as an industry

**Mbatia James:** Because the banks are finding ways to expand their market in the disguise of offering cheap credit.

**Dhiren Rana :** Mbatia the issue of awareness and financial literacy is a collective effort and I believe there are some examples and some banks and private training institutions have indeed taken initiatives in this direction

**Isaac Kiplagat :** So, Mr Mbatia, does a bank have a role in creating the awareness to the customer as to when he is ready to acquire a loan/credit?

**Dhiren Rana:** Although there is some degree of education... the credit officers during the credit assessment process do invariably take clients through the implications of borrowing a loan...and also consequences of default in terms of losing the collateral

**CHRISTINE VULIMU:** Is there a way that the banking institution could make their way into our educational system. To have hands on concerning how to manage funds?

I meant to say our youth. Is this too small to be addressed by this body?

**Zena Rashid:** interesting proposal Christine, would reach a wide audience

**CHRISTINE VULIMU:** Thank you Zena. Most young people have stumbled into their parent's debts in the name of family business and morgage.

**Dhiren Rana :** Christine on the education concerning how to manage personal funds...some initiatives are at concept stage so it will take a little bit of time before schools can benefit

## General Questions, Comments and Feedback

**BHARAT PATEL:** Is there a simple way to legalize the recovery of unpaid cheques as it is a part of cost of credit in my view

**Dhiren Rana:** Welcome Bharat Patel

I am aware that the Credit Reference Bureaus have a database of bounced cheques...this will therefore affect the credit rating of the drawer of bouncing cheques. Also, giving of a cheque that is not good is a criminal offence. Recovery of the amount of course is a court process, which is the legal framework

**Zena Rashid :** There is a case filed in court..... on the basis that interest rates charged by banks since 2004 are illegal, any thoughts on this?

**Dhiren Rana:** Zena...thank you for your question...the case in court is in relation to bank charges...as you appreciate; the matter is still in court and is being defended

**Shadrack Musyoka:** Congratulations Bwana CEO. The live chat is quite informative to the general public

**Chat Admin:** We welcome all visitors to check out information relating to APR on the KBA website <http://www.costofcredit.co.ke>

**Dhiren Rana:** I wish you acknowledge the presence in this CEO Chat of the KBA Chairman, Mr. Joshua Oigara...who is also the Group CEO of Kenya Commercial Bank

Joshua...thanks for joining us...this is testimony that the whole industry takes the interaction with the banking public very seriously...thank you for your valuable time

**Joshua Oigara :** Thank you Rana.

**Dhiren Rana:** As I wrap up, let me share that the KBA, CBK, and the Treasury are working together to enhance credit access and to lower the cost of credit, which includes interest rates and other charges and the high cost of doing business. Among the initiatives are measures to achieve reforms in the Lands and Companies registries; expansion of credit information sharing beyond banks to all credit providers; enhancing consumer protection practices; conceptualizing of alternative dispute resolution mechanisms; and transparency in the pricing which drives effective competition...some of these initiatives are already put in place (e.g. APR, KBRR) and others are on course.

**Dhiren Rana:** Thank you all so very much for joining this CEO Chat

**Lucy Matito:** Thank you sir for the insights

**Dhiren Rana :** I wish to invite you all to our next CEO Chat, scheduled next Friday at 10am when Mr. Sonola, CEO of GT Bank, will discuss the country risks, pricing of risks and credit information sharing



**Chat Admin** : Thank you Mr Dhiran Rana for taking the time to be with us this morning and hosting this informative chat session.

**Chat Admin** : Thank you to all of you for your questions, comments and insights. We look forward to being with you all online at next weeks chat session.

**Chat Admin:** You will be able to see the full transcript of this chat session and a podcast in the Archives section of the Chat website <http://chat.kba.co.ke> shortly.