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Chat Summary
Friday 12th September 2014
Topic: Risk Aspects that Influence the Cost of Credit.
Time: 10:00am-11:00am

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Risk Aspects that Influence the Cost of Credit

Adekunle Sonola: Thank you for joining us, it is good to be here. Thanks for taking the time to log on...I hope to learn as much as well...I hope it is an interactive session. I do understand that credit is a topical issue right now...the more we talk about it the more we get comfortable around the drivers of the cost of credit. It is an important topic...and we feel that it is one that we all should be interested in understanding.

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Anita Allela: Thank you Mr. Sonola for taking time to participate in this chat. Just as an overview kindly elaborate on some of the key factors that affect the cost of credit.

Adekunle Sonola: Good morning Anita...thank you for joining us

You have asked an interesting question...one which has multiple answers...to start with, the macroeconomic indices in any economic environment will determine the pace of economic activity in that environment, and ultimately the cost of value in that environment...for example, if the economy is in recession or growth mode it would have an impact on the cost of credit....

To simplify, in America for example the cost of credit has gone down significantly because that economy was in recession and therefore the Government had to intervene and significantly enable the market itself...empower the market to reduce the cost of credit

...if you take the case of Ghana for example...interest rates are still in the high 20s

...a mortgage in Ghana is over 30 per cent per annum...

...looking at the America and Ghana example, we can see that each market is unique in its own ways...

coming closer home, we can start with the fact that we have over 40 commercial banks, each with different cost structures...each with different credit ratings as an institution...and each with different credit risk appetite. Ultimately, all these factors as well as the risk profile of a company or an individual customer would affect the cost at which they borrow.

Anita Allela: Thank you for the answer, and am glad you have specifically referenced the Kenyan situation.

Adekunle Sonola: Anita, I hope the responses explain some of the issues...but there are several factors and I will be glad to answer any further questions you might have.

Alex Owuor: Good morning Mr. sonola?

Adekunle Sonola: Thank you Alex for joining. I hope you will have an interesting hour.

Martin Kimeu: Good morning Kunle,

Adekunle Sonola: Welcome Martin...it is good to have you here.

Alex Owuor: What are some of the factors that banks consider to offer credits to individuals?

Adekunle Sonola: Thank you Alex...in most markets the banks would consider each individuals personal circumstance, which would include employment status, average living standards in that market, the expense profile of the borrower, other credit facilities he/she has access to and the performance of those credit facilities...and ultimately his/her repayment capacity.

Allan Ochungo: Am currently banking with GTB Kenya, would like to know if I can access credit based on my banking and not collateral?

Adekunle Sonola: Allan...most banks in Kenya offer the unsecured loan product which is based on your account history, and the loan repayment performance of existing facilities, which is your track record. I encourage you to talk to the retail relationship officer at any branch and if you want I would be available to speak with you.

Allan Ochungo: Thanks boss, will do just that.

Lucy Matito: Good morning Mr. Sonola looking forward to know more about the risk factors.

Adekunle Sonola: Thank you Lucy...Allan asked the same question earlier...but if you have any specific questions, I'd be happy to answer them.

Elizabeth Muguiyi: Morning Mr. Sonala, the cost of credit in Kenya has been a thorny issue as Banks are said to charge very high rates. When you look at the risk factors in this economy, would you say that the costs are justified?

Adekunle Sonola: Good morning Elizabeth...

Welcome to the chatroom

Elizabeth, you have actually asked a very interesting question

My answer would be...the cost of credit, is not the issue. Let me explain.

If you look at the American situation. In trying to get the country out of recession, the Government (Federal Reserve...which is their central bank) rate is close to Zero percent...and the average market (bank) lending rate could be up to 6 percent based on individual circumstances...but the country has been slow to come out of the recession cycle.

The bank is a business as any other that also participates in the economy, and would bear some of the challenges that are unique to every economic environment...such as infrastructure, cost of communication, cost of human capital (labour), level of taxes, and credit behavior is very important and the effectiveness of the judicial / arbitration system.

In all instances, the risk profile of the economy has a bearing on the cost of credit.

Ultimately, Elizabeth, for every bank, given the level of competition in the industry, careful evaluation of the cost of lending is undertaken and includes some of the factors that I've mentioned.

Elizabeth Muguiyi: Interesting perspective makes a lot of sense.

Lucy Matito: How do banks compare to the micro-finance institutions which have now taken up offering more credit as compared to banks and don't you think banks are losing out by asking for too many things and subjecting customers to long waits only to end up denying them credit?

Adekunle Sonola: Thank you Lucy...your question comes at the right time.

Micro finance banks' lending rates are higher than banks, and with the exception of the deposit taking MFIs, most are not regulated by the CBK...that has an impact on their operations and their ability to serve the market quickly.

Banks are regulated...a thorough review of commercial banks is carried out by CBK on an annual basis, and sometimes more than once...and banks are required to comply by the CBK prudential regulations and a plethora of other international regulations...so you will find that most of the things we ask for from the customer are actually dictated by the regulations, laws and prudent risk management practices.

The fact that MFIs ask you for little / minimal information is compensated by the higher interest rate they would charge...it is a risk / reward principle...

Banks have a responsibility to ensure affordability when processing applications...

They also have a responsibility to motivate the right credit behavior.

Thus ensuring that individuals do not take on more credit than is sustainable for their level of income.

Lucy Matito: Interesting points, thank you sir but that brings me to my other question.

Lucy Matito: banks dont offer education when signing MOU'S with companies. They just give out the loans not bothering whether the money will be put to good use as long as they are signing on clients, how banks intend to tackle this issue as so many people are now in debt with money they took but did not put to good use

Adekunle Sonola: Lucy...I understand your perspective on education...

...however, we all have a responsibility as well. To ensure that they can afford the credit they are requesting...to ensure that they will put the credit towards good, productive use and not lifestyle consumption.

and borrowers should approach the system with transparency...not hide their debt obligations in an effort to access more credit.

Lucy Matito: Thank you sir. Well answered

Alex Owuor : Since all the banks have different credit rates, why don't the banks forms some body to regulate this rates so that all banks can have the same lending rates, so that an individual should keep on one bank not keep on shifting here and there.

Adekunle Sonola: Alex...thank you...I see your point that all banks should offer the same interest rate...but this would be difficult...banks do not have the same circumstances and all customers do not have the same risk profile.

Jonathan opiyo: Could it be ideal to have a standard on credit rather than having the current situation where each institution sets itself criteria where others undercut while others overcharge clients.

Adekunle Sonola: Jonathan...thank you...I believe the same applies as the response to Alex's point...

Velma Obuya: Hi Mr. Sonola, how are banks incorporating the risks that affect the cost of credit considering the new laws trying to regulate the banks' lending rates to customers? Will we ever see a time where the interest rates goes down to 6%?

Adekunle Sonola: Dear Velma...let me put the question back to you...I would like to get the reason why you would like interest rates to be at 6 percent?

Martin Kimeu: My question on cost on credit would be this; Given the various component in terms of cost that each bank factors in when pricing various products and bearing in mind the competitive nature of Kenyan market, what measures is GT taking to ensure that it competes favorably through cheaper cost of funds?

Adekunle Sonola: Martin Kimeu...to answer your question about competition...in Nigeria for example, the government identified priority sectors and committed a few hundred billion dollars, and set up funds that guaranteed lending to those priority industries...at a reduced rate...that did 2 things...it allowed those industries to get out of the credit market...thus increasing liquidity/availability of funding to other sectors and consumers, and my view is that it has been successful and that country is growing at an annual average of 6 per cent today.

The point is that Government intervention has to compliment the banks in ensuring a very vibrant economy and growth in personal wealth which ultimately improves consumption in that environment and reduces cost of credit.

Damaris Lilech: Good Morning Mr. Sonola, the high cost of credit affects the SMEs significantly yet they are a critical contributor to the economy and require credit more. What should be done to address this?

Adekunle Sonola: Thank you Damaris...that is a very good question...SMEs actually are the bedrock of every economy. SMEs is the sector where wealth is created, and the one that contributes most to poverty eradication.

In my view, what is needed more in the SME sector is education...training...financial education...we cannot hide from the fact that there is a significant level of failure within the first 3 years of existence of a business...therefore critically capacity building and institutional support will ensure an acceleration of the growth of the SME market.

And we must commend the banking industry in Kenya...as acknowledged by the World Bank study, as having the highest level of lending to SMEs in Africa...we can see that in Kenya we are doing some very good things already.

Conrad Karume: Good morning Mr. Sonola, If the element of risk dramatically increases, say due political instability or terrorism, would the cost of credit be affected for customers who are already servicing a facility?

Adekunle Sonola: Conrad thank you for the question.

The issue is the effect that political instability or terrorism will have on economic activity...if it leads to retrenchment or layoffs, somebody's ability to service the facility will be affected and every credit default by a customer has the following effects...

1. It increases the cost of credit to the system...generally

2. It makes the banks more cautious in their approach to lending

-the caution manifests in even more detailed evaluation of credit applications and assessment of the impact of future shocks on businesses and individuals….. Therefore there a real cost associated with such risks.

Conrad Karume: Thank you Sir well answered.

Charles Amanga: At the moment the Country Security has sent cold feelings within the investment circles. To what extend could this influence the cost of credit?

Adekunle Sonola: Charles Amanga...thank you...ultimately I believe the security challenges are transient, in the life of any country come up from time to time...so the international community will evaluate the likely long term impact, if any, and subsequently determine the cost of credit to that country.

Conrad Wambugu: Morning Sir, how are you different compared with your peers in terms of the East Africa Strategy, (Both Kenya and Nigeria (assumingly) have relatively high interest rates) and what advantage does GT have in linking west to East and vice versa

Adekunle Sonola: Wambugu...Kenya has a highly developed banking market...sophisticated and fairly lower risks when compared to other African markets. MPESA is a world-class example of innovation from the Kenyan banking market. And the statistics about financial inclusion in Kenya also points to the stellar work already being done by banks in Kenya.

Conrad Wambugu: Thank You Sir.

Peter Loolio: Good morning everyone, I would like to be given more info on the credit information sharing...most people are getting direct credit information from Saccos than from banks...how are we gonna merge this.

Adekunle Sonola: Peter...ultimately to have a vibrant credit market, and to correctly evaluate individual affordability, there would have to be a one stop shop for credit information...

...this would allow all participants in the financial industry to make the right decision, and ultimately, reduce the cost of default.

Adekunle Sonola: As we start to wrap up. I would like to thank everybody that joined us today for all the thought provoking questions that you have asked...and as we keeps the debate going.

Adekunle Sonola: My parting shot is that the industry is doing the best it can under the circumstances to reduce the cost of credit. The average cost of credit in Kenya was about 22 percent in the year 2012...today it has come down to less than 15 percent as at June 2014.

As we continue to grow the economy and address the risks we talked about today, and improve living standards, we will continue to see the appropriate lending rates in the market.

Adekunle Sonola: Thank you and have a wonderful weekend.

Unanswered Questions

Elizabeth Muguiyi: In regards to the new requirements by the Central Bank and the KBRR rates, do you anticipate that the cost of credit will reduce?

Conrad Wambugu: Are bankers all the same? What can we learn from the Nigerian Banker and most importantly what kind of discussion did you NOT find after taking office at GT Kenya? Why conversations are we missing that our west bankers have? Finally, Nigeria just by going on today's paper has a robust Public Private Partnership (PPP) body. What do you see in the EAC environment and how is GT Kenya going to bring investment and thereby growing GT Kenya itself?

Anita Allela: So do you anticipate the cost of credit in Kenya, taking into account all the factors discussed herein to go up or to decrease? What should the market anticipate?

George Mathui: What informs the rate of Default Interest Rate set by the different Banks in Kenya?

Jonathan opiyo: Why can't we have a credit standardization institution to avoid undercutting and overcharging of clients?

Conrad Wambugu: We see South African Bank supporting the banking sector as seen with CFC Bank which had the lowest interest rate for a long time/ What can we expect from GT Bank and its Kenyan arm.

Elizabeth Muguiyi: Mr. Sonala, thank you for your great insights, would you be available to mentor people in the Banking industry such as myself?

General Questions, Comments and Feedback

George Mathui: This was a superb interactive session. Thank you Kunle and have a wonderful weekend too

Conrad Karume: Thank you for hosting us Mr. Sonola, we look forward to the day the percentage Cost of Credit will drop to single figures.

Lucy Matito: @Chat Admin I think this session time should be increased as the debate seems to be very weighty. Thanks for this initiative though very informative.

Chat Admin: Hi Lucy, we encourage people to log on early and post their questions to enable us to get going from 10am.

Chat Admin: Thank you to all the participants for your great questions. The next chat session will be Friday 26th September where the topic will be Market Competition and the Impact on Cost of Credit.

Our host will be Mr. John Gachora CEO of NIC Bank.

We look forward to seeing you all online once again.

Chat Admin: The Kenya Bankers Association has developed and launched their Cost of Credit microsite which contains a lot of information on the topic of the cost of credit.

Chat Admin: You can visit this site at http://www.costofcredit.co.ke and also download the Android app to calculate the cost of credit.

Chat Admin: A transcript and podcast of this chat sessions will be available online shortly.