

MY CHAT WITH A CEO

September 22nd 2017
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LiveQ&A SESSIONS

Topic: **Developments in the Financial Markets**

with **Kihara Maina**
CEO, I&M Bank

Friday, Sept. 22nd
Time: 10am to 11am

KenyaBankers #CEOchat
Hosted by Kenya Bankers Association

22nd September 2017 CEO Chat Abridged Transcript

Opening Session – General Comments

Chat Admin: Good morning everyone. Glad you could log in this morning. We look forward to an engaging session on the chat this morning

Chat Admin: We are pleased to welcome you all to this morning's "My Chat with a Bank CEO" session

Chat Admin: Our topic this morning is Developments in the Financial Markets and our host this morning is Mr. Maina Kihara the CEO of I&M Bank Limited

Chat Admin: As we await the start, we welcome you to update your profiles and add in a picture of yourself. We would like to know more about you

Chat Admin: To get the discussion going straight away, please feel free to post your questions before we start so that we can kick off promptly at 10am.

Chat Admin: This quarter's theme is Redefining Banking and Finance and today's topic is Developments in the Financial Markets

Opening Remarks

Maina Kihara: Welcome everybody. Im glad to be hosting you here. Im sure we will have an interesting session.

Maina Kihara: So today's topic is very interesting because we have come a long way in the deepening of the financial markets. If I recall back to when I joined the banking industry...we had price controls at the time -- exchange rate controls, interest rate controls, capital controls...and I joined at the time these restrictions were about to be removed and when they were, we have since seen significant growth in our markets . Kenya is now seen as a shining example of a strong financial market in Africa.

... So welcome. And we will start addressing the various questions you have.

... I see questions have come in before I joined...Welcome Jeremiah, Festus, David...and a few other early birds! Thank you for joining and for your questions.

Money Markets, Financial Sector and the Economy

JEREMIAH NDALANA: Investors have little confidence in the Kenyan capital markets. This is due to losses that have been experienced in the past. How can this be improved?

Maina Kihara: To Jeremiah's question about confidence in the capital markets

... Actually, recent trends indicate somewhat of the contrary...we have seen the stock markets rise quite significantly from its low points...but, this reflects the expectation that we are going to see further growth in the economy and also that corporate governance standards are improving, even though we have seen some isolated challenges, but it is clear that the various regulators and the industries concerned have been serious about these issues. So as a result, we've seen external investors come into the markets, and more homegrown investors, and all this has helped drive up the stock indices over the last year or so. We have also seen significant interest in our debt markets (bonds) and this has also been as a result of deepening participation by market players like stock brokers and investment banks, as well as commercial banks.

Mukami Nyaga: With the many developments in the financial markets, what are the major reasons that limit Kenyans from investing in these markets?

Maina Kihara: Thank you Mukami...good question

... A key limitation to Kenyans investing in these markets is an understanding of how the financial markets work.

... We at the KBA are working to improve financial education. Working with banks for example to ensure that they explain their products to their customers. Indeed, this CEO Chat platform is actually an excellent platform to demystify the markets and how they work.

... Access to capital is another key limitation to financial market participation. And deepening also means taking care of micro investors as well as large investors. Hence, initiatives like M-Akiba which the industry has been instrumental in developing together with the Government and CMA, has been an innovative solution to providing access to government securities for small investors. Its the first of its kind in the world.

JOHN KIBE: M-Akiba recently introduced by the govt makes it more understandable to an ordinary citizen, are banks also likely to follow suit

Maina Kihara: John, thanks for your M-Akiba question...as mentioned to Mukami, its a key innovation and banks were involved every step of the way. Indeed our new PesaLink platform was used to facilitate investments into M-Akiba.

Kamau Kionga: can the industry repackage its assets (loans) for sale at the secondary markets at a discount.

Maina Kihara: I see Kamau's interesting question on how secondary markets can facilitate liquidity in the loan market

... So, to understand secondary markets, we need to explain that primary markets are where we get the initial issuance of securities or financial assets. For example a bond is issued by a company (say a bank)...and that is a primary market issue. Once issued, that bond can then be traded by different investors who are looking to participate in that financial asset; but had maybe missed the chance in the initial issue. So this trading of securities between investors constitutes the secondary market.

... So to Kamau's question of whether or not banks can repackage their assets (loans); yes they can. And actually the mechanisms to do so are already in place via the capital markets. For example, if a bank wants to sell its portfolio of mortgages, it can package those assets/loans into an asset backed security or ABS, and sell those securities. In this case, it would be a primary issue. The trading then of those securities would then be accessed by the secondary market players.

... In addition to Kamau's question...rating agencies play a role in rating that issuance. which brings into context Jeremiah's question about credit reference bureaus or CRBs, which serve the same purpose but for retail markets. CRBs have been really good for reducing the search costs that a lender incurs when assessing a borrower. And certainly the more CRBs we have licensed the better because it improves competition and lowers the costs for everyone. However, even with the number that we have right now, what's really important is data quality. And that means we need to enrich the information that the bureaus access; by ensuring that all providers of credit information are actually feeding information into the CRBs.

Kamau Kionga: Thank you Maina. This will be a game changer in the industry. How soon are we likely to see the first product?

Digital, Technology & Innovation

Onesmus Mukewa: Secondly, Blockchain (not cryptocurrencies)... Above the much hype/buzz, as we are heading to algorithm banking/Banking 4.0. What do you think can be practical problems blockchain can solve.

monkey king: Also, are Banks receptive to blockchain technology? Banks are loyal to their systems. Cloud is still facing resistance in adoption

Joel Owuor: What is the role of digital marketing in financial markets?

Edna Maritim: How is the Kenyan Banking Sector using #data and predictive analytics to guide and make their real Estate investment decisions?

marvin Collins: What is taking kenyans so long to embrace card payment?

Solomon Kababu: With the move towards mobile money, what is the future of banking

Elizabeth Njambi: Speaking of innovation and development. Why have most banks been slow to adopt mVisa?

Maina Kihara: Okay I see a number of innovation questions...digital banking, blockchain...mobile...thanks for your good questions

...Banks have always been early adopters of technology. And indeed the growth that we have seen in mobile banking and other alternate banking channels like internet, ATM, and so on, has been as a result of banks' willingness to adopt these innovations. The Central Bank of Kenya has also played a significant role in enabling innovation, by choosing to regulate after innovation. So it is my expectation that all the developments we are seeing in blockchain and digital banking, etc., will also be similarly transformational for our sector. Indeed, we have seen the impact on financial inclusion and its a great thing for more and more Kenyans to access financial services.

...So Joel to your point about digital marketing, well, the applications are limited by banks' creativity. The point is we should use digital to get closer to our customers.

Maina Kihara: Hi Edna, the question you raise is linked to digital and its impact...digital will impact all sectors that banks engage in, including real estate. Indeed, the KBA now has the leading real estate index (the KBA House Price Index) and as our data gets richer, and our analytics gets better, we will find the opportunities to serve our customers better in this space as well.

Maina Kihara: Marvin good question...actually we have over 15 million Kenyans using a combination of payment/ATM cards. Its a complement to all other payment channels. It is however easier to access credit through digital channels hence the low credit card penetration, which is about 250,000 cards.

Laura Kiama: Thank you Sir ,for giving us this opportunity to chat with you. Its often said that Information Technology is an enabler to business growth What in your view is the best way to bring in IT (specifically IT security) technology to support development in the financial markets

Maina Kihara: Laura thanks...I hope you saw my earlier point to the innovation question. Information Technology is at the heart of this. And banks are as I said great adopters.

Regulation, Interest Rates Capping & Banking Sector Trust

Onesmus Mukewa: The banking industry has been roughed up by the interest cap for almost a year, hundreds of jobs lost, huge NPLs, struggling SMEs... Being that the law is on the way to be repealed, what are your thoughts on how the banking industry should react, and forge a new plan ahead to regain itself?

David Indeje: What are the CEO's analysis of constraints and opportunities for the financing of SMEs in Kenya? This is especially in the wake of the Banking Act.

David Indeje: Is it true that the financial services offered by commercial banks to SMEs is away of solving their financing problems?

jimmy akali: On creation of employment and in the wake of interest rate capping, SMEs are finding it tough to access credit bearing in mind this group employs and contributes to Kenyas GDP, how wil banks salvage this situation?

Erick Asuma: Treasury & CBK have said the they are studying the impact of the rate caps with a view of lobbying the Govt to scrap the law. Many of you have complained that you have lost a big chunk of your income partic.. interest income. Could you quantify the impact of the law on your earnings since implementation?

Maina Kihara: There are a number of questions on interest rate capping, our position as banks, and the impact. Onesmus, Erick and others...thanks for raising this topical question.

... First off, what's important to understand about the interest rate capping issue is that banks are not proponents for high interest rates. Indeed, our position is that lower interest rates actually are helpful for economic growth. What's important is that we get those levels through market forces.

...Our position is that we should remove the challenges that drive high interest rates. Pricing is driven by competing demand for credit. So for example, government borrowing will help shape how banks price loans. Why does it do that? Because lending to government is low risk for banks. So we look at the price we would lend to the government, and then add a margin to cover default risk. We must also cover the cost of providing our services. And all this adds into the margins. As we get more efficient as an industry, the margins come down due to competition and innovation. Even before interest rate capping, bank spreads had come down significantly due to these factors. It is clear that with additional innovations in the way we offer our services and the cost of accessing third party services like Government registries, loan pricing can come down even further.

...Lower pricing of loans would allow us to lend more to our customers, but only if we can cover the risks. That means therefore, removing constraints to pricing allows innovation, and allows banks take more risks with borrowers.

... And this leads to the SME question that Jimmy has asked...If we can ensure that the SMEs are less risky in their business, through either insurance, removing information challenges (better book keeping), and so on, it would mean that banks would be willing to take on more risks within their SME portfolios. The price however, at which we do that has to reflect the risk that we are taking. And that's why the interest rate capping has adversely impacted SME access to credit.

...We as KBA are tackling our ability to service the SME sector within the current environment. We will soon be launching the Inuka SME program to help build capacity for micro, small and medium sized businesses. Banks are also actively engaging with insurance service providers, including Government, to derisk the SME sector. Also, banks are looking to set aside a portion of their portfolio to this sector.

Joel Owuor: Due to the collapse of banks such as Imperial and Dubai Bank, is it safe to still trade with banks in Kenya due to the given banking conditions where laying off of employees is the current norm. What is your take on that?

Maina Kihara: Joel you have the most important question of the day! Our key currency as banks is trust. Our customers must trust us. We have to therefore place a significant focus on integrity and corporate governance. This is non-negotiable. And as an industry we are setting in place a self regulatory mechanism that insists on the highest standards of corporate governance. This reinforces the efforts by various regulators to make sure that the banks are safe for all customers.

Joel Owuor: what is your take on the CBK's plan to introduce the Annual Pricing Rate model to enable customers compare different rates?

Maina Kihara: Joel visit costofcredit.co.ke so you can see that we have already taken steps towards greater transparency in pricing, including using APR.

Joel Owuor: thanks for your responses. Hope to interacting with you personally.

Festus Rotich: How will the implementation of IFRS 9 in January 2018 affect the players in the industry?

Erick Asuma: Hi Mr Kihara, in your own view, what are the implications of the IFRS-9 which becomes effective next year

Fred Mutisya: The most notable development on the Accounting side of the Financial Markets is IFRS 9 in 2014 for implementation from Jan 2018, as a follow up to the question on rating agencies, Do we have enough capacity to model Expected Credit losses and accurately provision loans at their origination? How will this affect Kenyan Bank performance going on?

Julia K Marami: Hi Mr Kihara. Fred Mutisya raised a question on IFRS 9 as a follow up to the question on rating agencies. Please respond? Thanks.

Maina Kihara: IFRS 9 will make it easier for banks to get closer to the regulatory standards for measuring credit risk exposure and provide for non performing assets. Its still early days and banks are building the necessary models to ensure that we are ready for the change in accounting approach.

Cybersecurity

Onesmus Mukewa: Good morning all. My questions will mostly be in Cybersecurity. In light that banks are heading mobile, and web. Are security implications being addressed, or just another catch-22 scenario like Equifax?

Elizabeth Njambi: Given the rise in use of Tcehonology in banking e.g mobile banking and internet banking, what measures do our banks put in place to protect from cyber crime

Maina Kihara: To the issue of Cybercrime raised by Elizabeth and Onesmus, its great to see our legislatures responding to this key emerging risk. Banks are also at the forefront of sharing information and shaping policy. So that we can tackle this major threat together.

Wrap-Up Session

Maina Kihara: Sadly our time is up!

Joel Owuor: Thank you.

Maina Kihara: I know that we still have a number of questions that we unfortunately haven't had time to tackle.

Maina Kihara: However we have a great team at the KBA who will compile the unanswered questions and I will share my responses and they will email them to you.

Festus Rotich: Thanks Bwana CEO for your time.

Fred Mutisya: Thank you.

Maina Kihara: I hope you have enjoyed the past hour interacting as much as I have. Thank you very much for your questions. I'm delighted to see how much interest there is in our industry.

Laura Kiama: Thank you for your time

Elizabeth Njambi: This chat is a good idea and quite enlightening. You should dedicate more time to the session next time. Thank you for taking the time to answer our questions today

Maina Kihara: I will ensure that your sentiments are shared with my fellow CEO colleagues.

Festus Rotich: Dear Admin.....I think we need to discuss on the time.

Maina Kihara: Thank you and have a great weekend!

Festus Rotich: One hour is not enough

Chat Admin: Ladies and Gentlemen, allow me to take this opportunity to thank Mr. Maina Kihara for being with us today and for his insights

Onesmus Mukewa: @Maina have a great day and weekend ahead of you

Chat Admin: We would also like to thank you all so much for your questions and comments. Your contributions have made this session a success

Conrad Karume: Thank you. This was very informative.

Concepta Imbali: I learnt something. Thank you

Chat Admin: Please join the CEO for a live session on Facebook at <https://www.facebook.com/ktnkenya> where he will wrap up today's discussion on Development in the Financial Markets

Onesmus Nyaberi: Is it possible that banks are now moving into offering Insurance services

Chat Admin: Please log into the Facebook session now to continue the discussion

Chat Admin: The chatroom closes in about 10 minutes. You can get copies of the transcript, podcasts and other information relating to this and all past chats in the Archive page of chat.kba.co.ke website

Chat Admin: We look forward to meeting you next Friday, 29th September at 10am. The topic will be on the Pathways to Home Ownership. We look forward to another exciting chat session

Alex Mugo: Thank you...see you then

Chat Admin

Have a good day and weekend ahead. ..Log onto Facebook live chat now!

Donald Madzika: Great informative chats. Thanks!

Tiberius Onsongo: great team,I love the direction we are up to.

Chat Admin: You're welcome join us again next Friday for another session. For now, you can join Mr. Kihara on KTN Kenya Facebook page as he answers more questions live

Unanswered Questions

The following questions were not answered by Mr. Maina during the CEO Chat session; however, he provided responses subsequently.

Financial Markets

JOHN KIBE: My Question To the CEO is; Financial markets are said to be the barometer of the economy&now that we have extended the electioneering period what are the likely outcome on the economy status,

Financial Markets do indeed respond to signals from the environment and electoral uncertainty clearly has an adverse impact to economic performance. To what extent that we will wait to see but considering we were already experiencing slowed growth this extension will make it more difficult to grow.

Joel Owuor: What are the steps that the banking sector taken to enlighten people about the forex trading?

This is part of the wider initiative on educating our customers via KBA banking efforts. However there is already plenty of information on the FX markets through various banks websites and all banks are quite willing to respond to detailed questions.

Joel Owuor: The trend of Sharia law in the financial market is big. How does it contribute to people of different religions

Shariah banking is based on the Shariah principles with respect to banking. It is accessible to all participants in the market regardless of their religion as long as the principles are respected. I

believe the CEOChat covered Islamic Banking in a past edition and I would refer you to the archives.

Onesmus Nyaberi: My main interest is with capital markets, why do banks as key brokers publicise less matters capital markets. Does it mean capital markets are limited to a certain sphere or cluster of investors?

Commercial banks will only focus on the markets that they serve when marketing their services. You will notice that those banks that do have Investment Banking units also market their services in this space. The licenses to operate in either market are granted by different regulators – CBK for Commercial Banks and CMA for the Capital Markets and the regulations in each have to be followed.

Interest Rates Capping & Regulation

JOHN KIBE: How did interest rate capping affect short term money markets e.g overdrafts
An unfortunate assumption in interest capping regulation was that one size fits all whether it was product types or customers with different risk profiles. Short term money markets can be considered as money markets with products of less than 1-year maturity. Overdrafts draw their pricing from these markets and should reflect their pricing as well as the risk profile of the users of the product. So long as the pricing achievable is unable to reflect the true costs of funds and risk then you will have supply issues.

JEREMIAH NDALANA: How is regulation doing to rogue Saccos in the financial markets?
We encourage any abuses to consumers to be reported to the regulatory authorities so action can be taken to rein it in.

Joel Owuor: why is the distribution of market power just skewed to only six banks making CBK ineffective in the past?

I don't agree the CBK has been ineffective. Market power comes with the necessary investments in scale or innovation. The focus should be on ensuring the smooth operation of Interbank markets by derisking them through appropriate methods that allow banks to borrow easily amongst themselves.

Ronny Mwirigi: Hallo Mr Kihara. There is this notion that the kenyan market is over banked factoring our population and numbers of banks operating. Recently the CBK lifted the moratorium to allow yet more banks in the industry, what is your take on this?

As long as the banks are strong in all respects and can compete effectively then it should be good for all consumers and should drive financial inclusion higher.

Laban Chege: I am running a private limited company offering credit only services and not taking deposits, is there any legal requirements or regulation in place for this kind of companies in kenya?

Other than meeting their business license requirements, credit providers that only lend are not regulated by the Central Bank because they utilise their own capital and do not pick deposits from the public.

Credit Reference Bureaus

JEREMIAH NDALANA: With large portfolio of Financial organization in kenya , is 3 CRB institutions enough to cover all financial institutions?

DAVID OTIENO: Hi Mr. Kihara what is your view on the idea that CRB's should be meant not to limit someone from accessing loan facilities as it is right now instead it should be able to give a risk rating for an individuals credit appetite?

I had answered CRB questions earlier however the key point to note is that a bank considers the information from the CRBs in their decision to lend. It doesn't mean that if one is listed you cannot access credit it just means that caution should be exercised and you can expect that the price will reflect your riskiness as indicated by the listing.

Cybersecurity

Laura Kiama: On cybercrime matters ,does this mean that IT Security budgets will now be getting priority at board level?

Cybersecurity goes hand in hand with enhanced provision of services via the internet and mobile. The best approach is to incorporate risk assessment in the technology investment decisions which is why it will remain a top Boardroom agenda.

Careers

JOHN MUIINDE: Hallo Mr Kihara, What do you think is the future of investment banking, hedge funds and private equity in this country and What would be your advise to any college student looking to pursue a career in this areas?

As long as there is a need for capital markets there will be a demand for skills in this space. Indeed in developing markets like ours there is a growing demand for Investment advisory skills as businesses require more capital market solutions in their evolution. Students should ground themselves in the base skills that are helpful in this space – legal, math, finance, economics etc to be better prepared for the training that is increasingly offered to facilitate investment banking.

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