Njuguna Ndung'u: Sustaining transformation and innovations

Remarks by Prof Njuguna Ndung'u, Governor of the Central Bank of Kenya, at the 3rd ICPAK (Institute of Certified Public Accountants of Kenya) Financial Services Conference "Sustaining transformation and innovations", Nairobi, 5 July 2011.

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Mr. Patrick Mtange, Chairman, Institute of Certified Public Accountants of Kenya;
Ms. Caroline Kigen, Chief Executive Officer, Institute of Certified Public Accountants of Kenya;
Distinguished Guests;
Ladies and Gentlemen:

It gives me great pleasure to be here today to open this 3rd financial services conference. Let me at the outset thank the Institute of Certified Public Accountants of Kenya for organizing this forum and for extending an invitation to the Central Bank of Kenya.

Ladies and Gentlemen: The theme of this conference is ***"Sustaining Transformation and Innovations"***. The choice of this theme is timely given the ongoing reforms in the Kenyan financial sector.

Ladies and Gentlemen: Kenya's current development blueprint Vision 2030 envisages the development and deepening of the financial sector. This will enable it to finance the development agenda while ensuring financial inclusion. For this reason, ambitious targets have been set of raising savings and investments to GDP ratio from 14% to over 30%. In pursuit of this strategy, the Central Bank in collaboration with market players has initiated several reforms geared towards creating an enabling environment and space for innovative financial services. With these reforms, we anticipate the financial sector will be stable, efficient and accessible. But also able to effect the necessary transformations. These initiatives include:

- ***Rollout of mobile phone financial services*** – The Central Bank has encouraged the adoption of innovative technological platforms such as mobile phones to extend the reach of financial services. Mobile financial services have in particular presented Kenya with an opportunity to significantly upscale access to financial services cost effectively. The Kenyan mobile financial services story has become a much acclaimed global case study. To date, over 15 million Kenyans transfer about Ksh.3 billion to each other daily with over one million transactions.

- ***Licensing Deposit Taking Microfinance Institutions (DTMs)***, whose focus is the lower end of the market, which is concentrated in the rural and peri-urban areas. The Microfinance Act, 2006 which empowers Central Bank to licence and supervise DTMs, was operationalised in 2008. Formalizing the operations of DTMs is expected to bring more people, especially those previously unbanked or underbanked, into the realm of the formal sector not only through their lending activities but also savings mobilization. This recognizes that in an economy with segmented markets, different vehicles are required for particular segments of the economy or market. So far 6 DTMs have been licensed with 1.35 million deposit accounts, 520,362 active loan accounts and Ksh.9.4 billion in deposits.

- ***Introduction of agent banking mechanism*** in May 2010 where banks were allowed to engage third parties to provide certain banking services. The aim is increased outreach of banks to the vast under-banked and unbanked Kenyan populace by introducing "banking beyond branches". It also enables banks to leverage on additional cost effective distribution channels to offer financial services. We have seen agency banking take banking to the people unlike previously when people had to go to the banks. So far 6,368 agents have been approved and are delivering financial services to Kenyans.

- ***Licensing credit reference bureaus*** to collect, collate, analyze and disseminate credit information among credit providers. Credit information sharing provides credit history (information capital) as an alternative form of collateral to the traditional physical collateral, to secure credit facilities from banks. Individuals will also be able to use their positive credit history to negotiate for better terms and conditions from their banks. On the other hand, banks will benefit from the mechanism since it will address the problem of information asymmetry that was used to raise a risk premium on loans and by extension the problem of non-performing loans which has in the past threatened the stability of the banking sector. The traditional problems of moral hazard and adverse selection that hinder financial sector growth have been minimized.

Ladies and Gentlemen: These innovations have seen our financial sector experience transformation as evidenced by the following outcomes:

- Exponential growth of bank branches from 740 in 2007 to 1,072 in April 2011.
- Increase in the number of loan accounts from 1.2 million in 2007 to 2.1 million in May 2011. The loan portfolio in the same period has increased from Ksh.533.8 billion in 2007 to Ksh.1.05 trillion in May 2011.
- Increase in the number of deposit accounts from 4.7 million in 2007 to 14 million in April 2011. Deposit values have grown from Ksh.709.8 billion in 2007 to Ksh.1.4 trillion in May 2011.
- Increase in the automated teller machines (ATMs) from 1,012 in 2007 to 2,153 as at 31st March 2011.

Micro savings accounts operated through mobile phones have increased to over 700,000 with a deposit level of Ksh.737 million.

Ladies and Gentlemen: The structural transformation of Kenya's financial sector has not been achieved without challenges. Key among these challenges is the need to balance the goals of financial efficiency, stability and integrity on one side with financial inclusion on the other. The role of the regulator in an economy like ours is also to develop the market and balance out these challenges. The regulator should, and especially after the global financial crisis, not look for avenues of more regulation but support transformation and innovation through better regulation. What is better regulation? From Sir Andrew Crockett, it is a regulatory regime that:

- Can readily identify weaknesses and emerging vulnerabilities.
- Is capable of analyzing risks and so adequately pricing risks.
- Provides appropriate incentives (penalties) to induce prudent behavior in the market place.

This will encourage innovations and strong institutions to develop in the economy.

Ladies and Gentlemen: The structural transformation experienced thus far is just but the beginning. The Central Bank and other players have earmarked several other reforms which are expected to take development of the financial sector to new frontiers. In addition, the Central Bank has embraced financial education as a critical component of its financial inclusion strategy. The consumers will then be equipped with knowledge to make informed financial decisions and to analyze alternatives.

In the same token, ***Ladies and Gentlemen***, as efforts progress towards a more developed financial sector, there is need to ensure existence of adequate disclosure of information by providers of financial services, efficient dispute resolution mechanisms, comparability of offers and data protection. As financial institutions embrace innovations, there is need to ensure that innovations have adequate consumer protection legislation. It is therefore encouraging to note that the constitution promulgated last year makes provisions for consumer protection. The constitution creates adequate space to build strong institutions to implement these provisions which will define appropriate incentives and rules of the game to encourage prudent behavior in the market.

Finally, Ladies and Gentlemen: While discharging your duties as accountants, auditors and advisers of financial institutions, you play a critical complementary role to the Central Bank in ensuring that such innovations are supported by sound internal controls of these institutions not to undermine safety and efficiency of the financial system, but at the same time provide enough room for innovation and development. Therefore, the Bank appreciates your role in supporting the banking sector reforms. But now, we also require your support on new ideas to introduce innovations in the financial markets to support and sustain its transformation as the theme of this conference ambitiously shows.

Ladies and Gentlemen: It is now my honor and privilege to declare this conference officially open and to wish you fruitful deliberations.

Thank you