Patrick Njoroge: Instilling confidence in the financial sector

Remarks by Dr Patrick Njoroge, Governor of the Central Bank of Kenya, at the stakeholders workshop on deposit insurance “Instilling confidence in the financial sector”, Nairobi, 20 July 2016.

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Good morning! It gives me great pleasure to be here with you this morning to take stock on the role of the Kenya Deposit Insurance Corporation (KDIC) in the financial sector.

At the outset, I am very grateful to KDIC for organizing this workshop. I also thank the Cabinet Secretary, National Treasury, for finding time to be with us this morning. I also acknowledge each one of you for your attendance.

The role of the financial sector in every economy need not be overemphasized. It performs a lubricating role in every economic activity just as oil does in machinery. A critical ingredient for the financial sector to effectively perform its roles is financial stability, which also underpins public confidence in the sector.

This brings me to the role played by KDIC in the financial sector. By being an insurer of bank deposits, its existence encourages depositors entrust their hard-earned savings to the deposit-taking institutions. Unlike the traditional Deposit Protection Fund, KDIC as currently constituted has an additional mandate of ensuring the going concern of its premium payers, the banks. This explains the close working relationship between CBK and KDIC. They both have complementary mandates of financial stability.

Kenya’s financial sector remains sound and resilient, supported by strong macroeconomic fundamentals. This is evident from the positive trend in key performance indicators of the banking system:

- The net assets grew by 5.6 percent from Ksh.3.6 trillion in June 2015 to Ksh.3.8 trillion in June 2016. This has been driven by increased lending.
- The total capital to total risk weighted assets ratio for the banking system stood at 18.1 percent as at the end June 2016, above the statutory minimum of 14.5 percent.
- The liquidity ratio for the sector has improved to 40.4 percent as at the end of June 2016 from 38.7 percent in June 2015. This is above the statutory minimum limit of 20 percent.
- The sector’s profit before tax increased by 2.1 percent from Ksh.76.9 billion in June 2015 to Ksh.78.5 billion in June 2016.

Nevertheless, despite the sector’s resilience, some difficulties emerged over the last year culminating in the placement under receivership of three banks (Dubai Bank, Imperial Bank, and Chase Bank). It is worth noting that none of these three banks was systemic, and the causes of the difficulties were unique to each of these banks.

CBK, in liaison with KDIC, has been working towards resolution of these banks. Additionally, the CBK seized this opportunity to further strengthen the banking sector. These efforts have placed us in “*the New Normal*” which is premised on three pillars:

First, greater transparency on the part of banks. The CBK is requiring greater transparency on the part of banks to ensure public confidence. This entails among others ensuring that banks’ financial statements are credible and reflect a true and fair view. Transparency also extends to other disclosures by banks on their corporate governance and risk management structures. In this regard, CBK has enhanced the disclosures by banks on their significant shareholders. Banks are now required to disclose details of significant shareholders who own 5 percent or more shareholding on their websites.

Shareholders are at the core of instilling corporate governance in banks. The disclosure of bank shareholders signals adherence to corporate governance as well as instilling confidence and stability in specific banks and the sector as a whole. At a minimum, the names, shareholding levels, composition of local and foreign ownership as well as group structures, for banking groups, should be disclosed.

Second, stronger governance with clearly demarcated responsibilities. It is only when all stakeholders of banks (shareholders, board of directors, management and external auditors) play their roles effectively that the performance of banks will continue on a positive trend. CBK has therefore insisted on clear demarcation of roles among bank stakeholders. On its part, CBK has been strengthening its supervisory practices including off-site surveillance to ensure that banks are truly practicing effective corporate governance. In 2015, CBK directed external auditors of banks to review the effectiveness of banks' ICT infrastructure as well as insider lending practices. The feedback from these reviews has formed a good base for focused supervision on the sector.

Further, CBK will shortly be issuing a consultative paper for review and comments on proposals to limit tenures of non-executive directors and Chief Executive Officers of banks. We all appreciate that unlimited tenures may breed complacency. We therefore encourage banks and all stakeholders to review our proposals when released, to ensure that the final guidelines are well-placed, useful and relevant to the sector.

Third, encouraging effective business models. Continued resilience of banks can only be realised when banks ensure that their business models are sound. The business models should be strengthened to accommodate new business lines and innovations rolled out by the banks. This informs the drive by CBK to ensure that they maintain sufficient capital to cater for existing and potential risks they are exposed to and their market niche. This informed the introduction of a 2.5 percent capital conservation buffer effective January 2015.

CBK also required banks effective 2013 to develop Internal Capital Adequacy Processes (ICAAP) to inform their capital management. Though most of the banks have embraced the requirement, we have noted that there is wide disparity on the ICAAP documents submitted to CBK. To this end, CBK will shortly be issuing a proposed ICAAP Guidance Note for comments. The Guidance Note is expected to strengthen ICAAP management with capital holdings that are aligned to banks' risk profiles and business requirements.

As I conclude, it is also worth touching on Brexit. While the economic impact thus far has been muted, Brexit has created a lot of uncertainty in the financial markets globally. We are also aware of the likely impact on trade, since countries such as Kenya may be required to negotiate new bilateral agreements with the United Kingdom once it exits the EU. This may have an impact over the medium term, with reduced foreign direct investments as well as export earnings from the UK and EU. CBK is keenly following these developments and is ready to take appropriate actions to safeguard the stability of our economy and the banking sector in particular.

With these remarks, Ladies and Gentlemen, it is now my distinct honour to invite the Cabinet Secretary, National Treasury, Mr. Henry Rotich to officially open the Workshop.

Karibu Bwana Waziri!