Njuguna Ndung'u: Credit information sharing to enhance financial sector development

Address by Prof Njuguna Ndung'u, Governor of the Central Bank of Kenya, at the launch of the Banking Credit Information Sharing Implementation Project, Nairobi, 27 August 2009.

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Mr. Martin Oduor-Otieno, Chairman, Kenya Bankers Association;
Mr. John Wanyela, Executive Director, Kenya Bankers Association;
Chief Executives of Commercial Banks here present;
Distinguished Guests;
Ladies and Gentlemen:

I am pleased to join you this morning on this important occasion to launch the Banking Credit Information Sharing Project. Allow me therefore to extend my gratitude to the Kenya Bankers Association for facilitating this project and the invitation. The importance of this function cannot be overemphasised and I am delighted at the excellent turnout of the banking fraternity.

The Banking (Credit Reference Bureau) Regulations 2008 were published in July 2008 and launched at this very venue in September 2008. The Regulations paved the way for the licensing and surveillance of Credit Reference Bureaus (CRB) by the Central Bank of Kenya. These Bureaus will collate credit information from institutions licensed under the Banking Act. I am pleased to report that since the Regulations became operational in February 2009, there has been considerable interest by potential investors. I do believe that interest is for those who cherish the importance of the development of information capital.

The Central Bank has so far received three applications for CRB licenses, two from local investors (Credit Reference Bureau Africa and Metropol) and one from a South African based regional player – Compuscan. Accordingly the Central Bank has this week issued a letter of intent to the first applicant, Credit Reference Bureau Africa. This is an approval in principle to conduct credit reference bureau business. The Bureau will commence operations on completion of an independent third party system and security audit and an onsite inspection by CBK. The letter of intent was granted after a detailed due diligence of the application to ensure all statutory and prudential requirements were met. The Central Bank wishes to reassure Kenyans that it shall rigorously assess all applications to ensure the integrity of the envisaged credit information sharing mechanism.

Ladies and Gentlemen: The launch of this project today by the banking sector is therefore very timely. The overarching objective of the project is to co-ordinate the efforts of all players so as to build a sustainable and holistic information sharing mechanism. The Central Bank renders its full support to this project and we expect that all banks will also commit to implementing all the agreed milestones.

Credit information sharing offers Kenya an opportunity to promote access to affordable credit to more Kenyans because information lowers the risk premium and search costs. There is indeed a clear and direct linkage between access to credit and economic development. Allow me to highlight four key benefits that the Central Bank sees accruing from this initiative.

First, credit information sharing will facilitate the development of information capital. The risk premium associated with information asymmetry and search costs will decline. Second, information capital will change the current collateral technology. Credit by the banking sector in Kenya has to a large extent been underwritten by physical collateral such as land. Borrowers without access to such collateral have been constrained in accessing credit. Credit information sharing will enable borrowers build a track record that can be used in accessing credit. This will be especially pertinent to those borrowers in the informal and

Small and Medium Enterprises (SMEs) who have a track record and good performance to use it to access credit. The SME sector is very important to the industrial development of this country and the Vision 2030.

Ladies and Gentlemen: The third benefit is to enhance information symmetry and support financial development. The existing state of information asymmetry between borrowers and banks is a constraint to innovation. Two important outcomes in information asymmetry: moral hazard problems from the borrowers and adverse selection from the banks. These two problems could punish the economy with low provision of credit. We have also seen that there is adverse selection among banks as well.

Fourth, in a segmented market like ours, some segments remain untapped because banks do not have adequate information to price suitable products. In part this has also contributed to the high cost of credit. Borrowers have had to bear a “risk premium” because of this lack of information. It is therefore the Central Bank’s expectation that savings arising from the increased credit information shall translate to lower cost of credit. In turn, more Kenyans will be able to access credit from banks.

The current level of interest rates is a combination of costs (like information search costs), risk premium and of course banks’ profit margin. High interest rates also give rise to default risks. The risk premium and search costs can be minimized by information symmetry and reduce Non-Performing Loans. As you will recall the Kenyan banking sector was saddled with a huge non performing loan portfolio in the 1980s and 1990s. Part of the burden was occasioned by “serial defaulters” and inadequate incentives to have a good credit history. The days of “serial defaulters” are definitely numbered with the advent of credit information sharing. More importantly, we expect that there will be incentives for good credit behaviour that will attract competitive pricing of credit facilities. The message to Kenyans is that now more than ever before, there will certainly be benefits accruing from adhering to the contractual terms of loans. I am sure the other institutions in Kenya will deal with appropriate definition of property rights and contract enforcements to further reduce the risk premium.

Ladies and Gentlemen: In a nutshell, credit information sharing will increase vibrancy in the market for the borrowers and lenders. Borrowers will be able to access enhanced facilities as they grow their credit histories and track record. Conversely credit providers will be able to develop new and competitive products that will tap into previously unserved and underserved market niches with the power of available information. This can only impact positively on the banking sector and the Kenyan economy as a whole.

As I draw to a close, let me recognize that the banking sector credit information sharing initiative will serve as a model for other credit providers. We must move with speed to have the mechanism up and running and begin to rope in other financial and non financial credit providers. This will allow the full benefits of credit information sharing to the whole economy. I therefore urge all banks to support this initiative which the Central Bank is unreservedly committed to.

It is now my distinguished duty to officially launch the Banking Credit Information Sharing Implementation Project.

Thank you.