Njuguna Ndung'u: Increasing access to credit

Keynote address by Prof Njuguna Ndung'u, Governor of the Central Bank of Kenya, at the official launch of the first licensed Credit Reference Bureau – CRB Africa Limited, Nairobi, 4 March 2010.

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Chairman, CRB Africa – Mr. Michael Karanja;
Chief Executive Officer, CRB Africa – Mr. Wachira Ndege;
Board Members, CRB Africa, here present;
Chair, KBA – Mr. Martin Oduor-Otieno;
Executive Director, KBA – Mr. John Wanyela;
Chair, Vision 2030 Delivery Board – Dr. James Mwangi;
Distinguished Guests;
Ladies and Gentlemen:

I am pleased to join CRB Africa and the banking fraternity in the launch of the first ever licensed Credit Reference Bureau in Kenya. The launch marks a new dawn in the Kenyan banking sector. It is the first and most important step towards building information capital. The second step will be for the banks and the public to share this information; and the third step will be to use the information to develop the market and to make appropriate decisions.

I would like to commend the Board and Management of CRB Africa for their enterprising efforts culminating in their being licensed as the pioneering Credit Reference Bureau in Kenya. This is a landmark achievement worthy of congratulations from each one of us.

Ladies and Gentlemen: The main objective is to increase access to credit. We know the benefits of credit access and cost effectiveness of that credit to development at the firm level and at the household level. Allow me to focus briefly on the benefits which CBK sees as accruing from the adoption of credit information sharing in Kenya.

First, credit information sharing will facilitate the development of information capital. The risk premium associated with information asymmetry will henceforth be eroded. This will allow cost of credit to decline substantially. 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 and buildings and costs of evaluating that collateral – with inappropriate definition of property rights. Borrowers without access to such collateral have been constrained from accessing credit. Credit information sharing will thus enable borrowers to build a track record (reputational capital) that they can use to access credit. This will especially be pertinent to those borrowers in the informal and Small and Medium Enterprises (SMEs) who have a track record and good performance to use their reputational capital to access credit. The SME sector is very important to the development of this country as envisaged in 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 and financial sector development. Two important outcomes in information asymmetry are the moral hazard problems from the borrowers and adverse selection from the banks. These two problems punish the economy with low provision of credit. Information asymmetry has also led to severe adverse selection among banks themselves.

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.

As you all know, the Monetary Policy Committee's (MPC's) efforts since September 2009 to signal to the market the need to expand credit to the private sector at affordable interest rates has not yielded the desired results. Banks have continuously cited structural rigidities as impeding their wish to lower interest rates. With the launch of credit information sharing, we believe it signals the seriousness with which their concerns are being addressed. Banks should henceforth pass the accruing benefits to the Kenyan public through appropriate reductions in the cost of credit.

Ladies and Gentlemen: The current level of interest rates is a combination of costs (like information search costs); risk premium most of it unrealized goes to profits; our legal system with delays and lack of clear enforcement of contracts; and of course banks' profit margin. High interest rates increase the level of default risks. With good credit track records, the risk premiums and search costs imposed on customers will ideally shrink. In this regard, we expect that credit information sharing will be an incentive 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.

Ladies and Gentlemen: In summary, credit information sharing will increase vibrancy in the market for borrowers and lenders. Borrowers will be able to access enhanced facilities at competitive prices, as they grow their credit histories and track records. 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. The vibrancy of the credit market implies availability of resources for the productive sectors of the economy to exploit the otherwise moribund opportunities.

But we should also not forget it is the end of the road for serial defaulters who took advantage of information search costs and information asymmetry to defraud banks and individuals – including bouncing cheques for lack of funds.

Having said all that – ***Ladies and Gentlemen:*** Let me now take this opportunity to thank our development partners and donors, in particular, the Financial and Legal Sector Technical Assistance Project (FLSTAP), Financial Sector Deepening (FSD) Kenya and the International Finance Corporation (IFC), for their unwavering support over the more than 4 years we have committed our efforts to developing an appropriate credit reporting mechanism for Kenya. I would also wish to recognise the efforts put forward by the market players led by KBA who unreservedly partnered with CBK in developing the regulatory framework and in hosting the Kenya Credit Information Sharing Initiative (KCISI) which has put in place the modalities of operationalising the initiative.

I urge all banks to support the ongoing pilot run by KCISI aimed at ensuring that all banks are fully prepared to as seamlessly as possible participate in the sharing of their credit information. The ability of all banks to participate in the initiative is the only way they will reap maximum benefits. The project manager and his team at the KCISI have assured me that they are ready and available to assist all banks to ensure compliance.

Ladies and Gentlemen: The role of easily accessible and affordable credit in economic development need not be overemphasized. However, most banks finance their credit with short term deposits which constrains their credit structures to mainly short term. This is even more punishing because the overdraft facilities for working capital are also short-term and very costly. We thought with a vibrant bond market, this traditional mismatch would go away! In an effort to address the mismatch, a Technical Committee has been formed by the CBK to look at proposals for Development Banking Products or development loans with longer tenors than the current term loans in commercial banks. Supply of long term funds will support this line of development. The key target markets for the Development Banking Products are the SMEs with huge growth potential.

To further address the structural rigidities in pricing of credit, CBK will later in March 2010 launch a study report on collateral system and associated costs in Kenya. The study, jointly commissioned by KBA, CBK and FSD Kenya, is aimed at establishing the current status on creation, perfection and enforcement of collateral in Kenya. Recommendations to overcoming any existing obstacles are expected to be detailed in the study report.

Ladies and Gentlemen: As I draw to a close, I would like to assure you that the CBK in collaboration with the Government and the market players will enhance its efforts in addressing other structural rigidities that contribute to market inefficiencies – for this reason, we would also like to hear from the market as well – to take stock of developments as well as other emerging constraints.

Ladies and Gentlemen: CBK believes that the banking sector credit information sharing initiative should serve as a model for other credit and utilities providers. CBK will engage other players to ensure that we move with speed to rope in other financial and non financial credit providers. To this end the Microfinance Act was amended vide the Finance Act, 2009 to permit credit information sharing. Inclusion of all credit providers and utility service providers will allow the full benefits of credit information sharing to permeate through the whole economy.

Ladies and Gentlemen: It now remains for me to wish CRB Africa all the best as they commence their operations. We do believe that the licensing of CRB Africa and other CRBs in future will go a long way in positively altering the Kenyan banking sector landscape. We want to build strong institutions in the financial sector and information capital is one of the pillars of a strong institution. As I have emphasized, strong institutions define the appropriate incentives (punishments) that encourage prudent behavior.

With these few remarks, ladies and gentlemen, it is now my honour and pleasure to declare CRB Africa officially launched.

Thank you.