Njuguna Ndung'u: Costs of collateral in Kenya

Remarks by Prof Njuguna Ndung'u, Governor of the Central Bank of Kenya, at the Launch of the Study Report on "Costs of collateral in Kenya", Nairobi, 24 March 2010.

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Hon. Uhuru Kenyatta, Deputy Prime Minister and Minister for Finance;
Permanent Secretaries, here present;
Mr. Martin Oduor Otieno, Chairman, Kenya Bankers Association;
Mr. John Wanyela, Chief Executive Officer, Kenya Bankers Association;
Mr. David Ferrand, Director, Financial Sector Deepening Trust Kenya;
Distinguished Guests;
Ladies and Gentlemen:

It is with great pleasure that we congregate here this morning to chart the way forward on another avenue of enhancing efficiency in our banking system. This is through changes in the collateral technology in use. But before I make my remarks, allow me to thank the Hon. Deputy Prime Minister and Minister for Finance for agreeing to grace this occasion and deliver a keynote address. Also, allow me to thank KBA and FSD for their tireless effort to deepen the financial sector.

Yesterday, we held our Monetary Policy Committee meeting in Mombasa CBK Branch. The first review was a survey on what sustains high interest rates – The response from the market showed two factors; cost of credit and credit risk sustains high interest rates. But what is behind cost of credit and credit risk – perhaps the collateral technology in use. The cost of collateral is being addressed today by this study.

Ladies and Gentlemen: Kenyan banks have persistently cited cost of collateral as contributing a significant portion of premium factored in the interest rates they charge. To demystify the assertion, CENTRAL BANK OF KENYA (CBK) and Kenya Bankers Association (KBA) in conjunction with Financial Sector Deepening Trust (FSD) Kenya commissioned a study to review the Kenyan collateral process with a view to determining the costs associated with each step in the process. The consultants were also required to put forward succinct recommendations based on their findings. Evidence seems to show that the three steps of collateral process in Kenya; that is: ***creation, perfection and enforcement,*** entail enormous costs and time.

Ladies and Gentlemen: The report has brought forward several recommendations. They will be implemented and will result in both cost and time reduction. The implementation of the recommendations touches on several Government agencies, most of which are represented here today. I believe your presence in this occasion goes a long way in showing your readiness to play your part in addressing the constraints noted.

The study has indicted the collateral process in Kenya; the collateral process is flawed and as a result it is characterized with high costs. There are more than 20 applicable statutes relating to collateral creation and perfection. This makes the process cumbersome, expensive and complex. It is high time the statutes are looked at to not only ensure uniformity but also simplify the process. Lenders have cited the slow and expensive judicial process as contributing to premiums they factor in their interest rates. A certain and reliable judicial process facilitates quick recovery by lenders when secured facilities are defaulted. Good borrowers will thus not be penalized for a mistake that is not of their making. In addition, there are many manual and uncoordinated registries.

Ladies and Gentlemen: What are the other complementing initiatives to this study: Going forward the following two events will shape the outcome of the recommendations of the report.

- First, the licensing of credit reference bureaus has introduced a substitute to physical collateral, which is information capital and reputational capital as well as appropriate risk pricing. CRB Africa was launched early this month. It is expected that the credit information sharing mechanism will be fully operational by July this year and as a result we expect to subsequently see a reduction in costs of credit as banks pass the resultant benefits to their customers. Similarly, it is high time that Kenyans henceforth adhere to their credit contract terms in order to build favourable credit track records for use as information collateral.
- Second, the CBK and KBA have formed a committee to drive forward the recommendations of the study. The formation of the committee reflects the importance attached to the study by both KBA and CBK. The implementation of the recommendations will not only be beneficial to the financial sector but the entire economy. This will happen at three levels:
  - First, through the supply of required credit in future.
  - Second, through lengthening the maturity profile of term loans.
  - Third, the appropriate definition of property rights and certainty in enforcement of contracts will be strong building blocks of a deepened financial sector.

It is therefore important and complementing to explore the widening of the membership of the committee to include the various players represented here today. A broad based implementation committee will support the quick execution of the cross cutting recommendations contained in the report.

Ladies and Gentlemen: As I conclude let me take this opportunity to thank FSD Kenya, our development partner in several projects aimed at inclusive financial markets in Kenya; Kenya Bankers Association who partnered with us in this study; ShoreBank International and Walker Kontos who authored the report being launched today; and all market players who took part in the study; but more importantly those who came here today to take part in the launch and I am sure they do believe we can achieve the prescribed results.

Finally, ***Ladies and Gentlemen,*** let me let me take this opportunity to invite our chief guest to address this gathering.

Welcome Deputy Prime Minister, Hon. Uhuru Kenyatta.